



Hadrian Brief

October 2, 2010

Growth and Inflation

Global economic growth has found a slower pace, and is being led by activity in India and China. In fact, the Asian Development bank raised its forecast for 2010 Asian growth 0.7% to 8.2%. Robust economic activity in India and China sparked the upward revision. Strong private demand and the sustained impact of stimulus were growth drivers. Weakness in industrial nations was seen as the downside risk to the forecast. The economies of Australia, Japan, and South Korea are expanding, but the pace of activity appears slower. Growth in Europe and the U.S. is being restrained by anemic consumer spending and the headwinds of restrictive fiscal policy. *Global trade tensions have elevated and present a risk to growth.* Increased tensions are illustrated by the recently passed Chinese currency legislation in the U.S. House of Representatives, the recent slowdown of Chinese rare earth exports to Japan, China's move to raise tariffs on poultry, and reports that the EU may tax steel tubes and pipes imported from China.

Inflationary pressures remain limited in the U.S. and Europe, but remain present in the emerging world. High commodity prices such as coffee, cotton, copper, and sugar are leading to price pressures, but end market competitive is strong and limiting pass through. Further, there is ample slack in the OECD. Rising gold prices and the willingness of the Fed to expand its QE program are helping to lift inflation expectations, and balance still weak real estate pricing. Additionally, credit growth in the developed world is limited and inconsistent with the building blocks of inflation. In its recent policy statement, the Fed highlighted deflation risk, while a strong yen is helping to keep Japan's CPI negative. Home prices remain capped in the U.S. and U.K., although Hong Kong recently recorded a record high price for an apartment sale.

Money Markets

The U.S. treasury market is fixated on the prospects for another round of quantitative ease by the Federal Reserve. The treasury long position is crowded, but expectations for more Fed purchases are keeping real money and hedge funds players long and buying dips. Recent client surveys have displayed treasury portfolio managers are overweight to benchmark, while bond funds attracted \$60 bln in July and August. Fed member rhetoric, a WSJ story, and the recent policy statement suggest the Fed could announce a second asset purchase plan at the early November FOMC meeting. The Fed is already investing funds from maturing agency and MBS securities into treasuries in order to keep its balance sheet size stable. A new purchase program would further reduce treasury supply to the private sector. The Fed may be trying to engineer a 30 year fixed mortgage rate below 4.25% in order to spark aggressive refinance activity and lift lackluster housing demand. Beyond the Fed, weak housing and labor markets continue to underpin treasury prices. Furthermore, the core CPI has been consistently below 1.0% in recent months. Treasuries are unattractive relative to corporate debt and equities given dividend yields and expected earnings, but lack of solid economic growth and the threat of higher taxes is preventing competing assets from finding normalized value. Treasuries are unattractive relative to JGBs and Australian government debt, but there is little competition from German and UK government debt. A rise in Germany yields would undermine the treasury rally given lack of yield compared to Asia.

Foreign Exchange

The dollar will be driven by the outlook for the Fed to step up asset purchases, which are dependent on the pace of economic growth and inflation. The **euro** will be helped by the ECB distancing itself from QE and the results of recent LTRO which suggested reduced demand for ECB funding. Late September repo results imply funding needs are working into the private sector which will lift Euribor relative to U.S. LIBOR and give the euro a favorable

interest rate differential. Fiscal austerity in Europe is moving forward. There has been a favorable reaction to austerity plans in Portugal and Spain, but skepticism over the ability of Ireland to stabilize its banking system remains with Anglo Irish and Allied Irish needing capital and support. Domestic demand in Europe is soft, and a stronger euro and downshift in global demand will hurt the economy and act to cap euro gains, although export competitiveness concerns are likely closer to 1.50 than 1.40. The **sterling** will be sensitive to the BOE's desire to expand its asset purchase program. The idea that the BOE is willing to expand QE is pressuring the sterling relative to the euro. Tax and regulatory policy remain negative for the sterling, but are well known. Economic numbers have been uneven, but not weak enough to put the BOE ahead of the Fed in another round of asset purchases. BOE member Sentence also remains hawkish and against easier policy in contrast to BOE member Posen. The **yen** remains strong helped by lack of interest rate differential to Europe and the U.S. along with increased Chinese interest. Recent currency intervention, rumored around \$23 bln, has failed to reverse the yen's trend against the dollar. Slower export growth and a dimmer outlook in the Tankan will provide some pressure, but conditions are not weak enough to overcome the idea that the Fed may boost asset purchases. The main downside risk to the yen rests in the desperation of the government to defend the export sector and the chance the BOJ steps up measures to ease monetary policy to cap the yens' gain. The **Canadian dollar** may lose some of its luster in the wake of recent comments from BOC Governor Carney who warned the BOC may be slow to raise rates. Recent economic data has had a softer tone. However, a relatively healthy banking system and still high commodity prices are a plus for the Canadian dollar. The **Australian dollar** is being supported by the strength in the Chinese and Indian economies, and increased expectations for further monetary tighten. Recent comments by RBA member Lowe highlighted the importance of

China and India to the Australian economy. He noted that India would follow in the foot steps of China and add to Australian growth. Additionally, Lowe suggested that strong consumption could stoke inflation. In recently released minutes, the RBA noted that prospects for the resource sector were high, the growth outlook had improved from the month prior, and higher rates would likely be needed if growth continued at its current pace. Even though the RBA appears more hawkish, the weakness in the manufacturing PMI and signs of softer housing demand temper the outlook for a rate hike.

Equities

The S&P 500 is expected to work sideways to higher into the release of Q3 earnings mid October. Stocks continue to show signs of value given price to book ratios in the semiconductor and banking sectors. Furthermore dividend yields on blue chip names such as Duke Energy, Caterpillar, Verizon, and Intel are high relative to the yields on the 10 year treasury and cash. However, concerns over the growth outlook in 2011 and uncertainty over tax policy are creating a headwind to a rally. Dividend, capital gains, and margin tax rates will be decided after the mid term elections and there are risks these tax rates rise. The trend of companies raising earnings forecasts relative to reducing earnings forecasts has been firm and suggests Q3 profit numbers will meet expectations. Looking forward, the trade will be nervous about the ability of companies to post strong growth into next year as the global economy has less momentum and year ago sales and earnings comparisons become more difficult. Lastly, the mid term election cycle has tended to be friendly for the market into year end. Mutual fund data from the Investment Company Institute continues to show investors liquidating mutual fund holdings. The sales have come despite the S&P 500's best September since the 1930's. The flow of mutual fund sales suggests investors are poorly positioned for rally.

Commodities

Commodity prices will be sensitive to the pace of global growth, and weather trends. Investors remain interested in owning commodities. In the last reporting period, the CFTC indicated the net long position held by non-commercial accounts hit its highest level since February 2006. Signs of a soft landing in China have helped to support prices. Weather patterns are likely to influence the outlook for grains, cotton, cocoa, coffee and sugar in the coming weeks. The North American harvest and planting in Brazil will drive trade, as the market worries that La Nina will lead to dry weather in Brazil, and excessive rains in the cocoa growing areas of Africa. During the month of October, 16 of the 19 commodities in the CRB rose. Sugar, cotton, and OJ were the best performers. Wheat, natural gas, and cattle declined.

The **oil** market is being driven by the outlook for economic growth and has been sensitive to equity prices. There appears to be a balance between supply and demand. Signs of a Chinese soft landing have helped to put a floor in prices, but demand in the OECD does not appear strong enough to spark a major rally. There is a comfortable level of crude oil supply in the U.S. as highlighted by the recent discount of WTI to Brent. In the period ending September 24th, the U.S. days supply of crude oil was 24.0 versus 22.8 a year ago. Crude oil inventories have been working flat since May and have failed to experience a normal seasonal decline. Domestic production has been firm in recent weeks, while import numbers have been dropping off post increases between January and August. After a period of a period of counter seasonal strength, gasoline inventories fell in the week ending September 24th. However, supplies are ample with a 24.4 day supply (23.4 a year ago). Gasoline demand is easing seasonally, but firm relative to last year. In the period ending September 24th, the 4-week average of gasoline demand was 9.128 mbd up 0.8% y/y. Gasoline demand

has consistently run above year ago levels in recent months. Distillate supplies are ample going into the heating season. Although down from last year, distillate supplies are high given the 45.2 days supply (50.5 last year). However, distillate demand continues to be firm and has consistently tracked ahead of last year. In the 4-week period ending September 24th, distillate demand was up 13.4% y/y. In Asia, China crude oil inventories rose 3.4% m/m in August. But, oil product inventories fell 5.4% m/m in August. Diesel declined 7.3% m/m, while gasoline decreased 2.7% m/m.

Natural gas prices will be driven by economic output. Natural gas supplies are elevated at 3.414 Bcf. Although 4.6% below year ago levels, inventories are 6.3% above the five year average and stocks are likely to build further as the market enters into the final weeks of the injection season. Storage capacity continues to expand, and a scenario of no available storage is unlikely. Demand trends are mixed. BENTEK reports that natural gas demand is up 4.2% from 2009 year to date. Increased demand has been driven by the industrial sector and electric power usage. In contrast, residential use and commercial consumption are down from a year ago. Hot weather this summer helped to lift electric power usage. Industrial output found a softer footing in September given regional purchasing managers surveys, and the economic expansion is continuing at a slow rate. In the last week of September, temps were above normal and heating demand has been limited. Looking forward, the 8 to 14 day forecast, stretching into mid October, has temperatures below normal in the Gulf Coast through the East Coast, but south of Illinois, Indiana, and Ohio. Most of the Midwest is expected to see normal temps with the Northwest above normal. Weather patterns are unlikely to shock prices, and change market direction.

Copper prices will be driven by signs of economic growth and dollar weakness. Strength in the Indian and Chinese economies is offsetting weakness in the OECD and helping

to lift gold prices. LME stocks have trended lower since February and stood at 373,800 tons on October 1st. Although stocks have declined, they are elevated to the 2007 to 2008 period. In Shanghai, copper stocks have declined to a one year low. As of September 30th, copper stocks in Shanghai stood at 87,447 tons. The International copper study group projected a 435,000 tons deficit in 2011 predicting that production would expand 1.1% and demand would increase 4.5%. Specifically, Chinese usage was forecast to rise 6.0% in 2011. News that copper output in Peru fell 4.5% in August was also a benefit to the market. In contrast, Chile's copper production displayed a vibrant sequential gain and rose 1.3% y/y. Like gold, copper is benefiting from a weak dollar, and signs the Fed is open to expanding quantitative ease. Recent signs of a soft landing in China and comfort with the Chinese government's policies to cool property prices have also lifted copper prices.

Gold prices are being supported by hot money flow linked to ideas the Fed will increase its holdings of treasuries and the dollar will weaken. The Fed's move to jaw bone treasury yields lower has reduced the opportunity cost of holding gold. The level of the 10 year treasury has explained 62% of the price of gold in 2010. Furthermore, talk of quantitative ease has weakened the dollar boosting gold's shine. On the physical side of the market, high prices do not appear to be reducing demand. Russia increased its reserve holdings of gold by 18.5 tons in August to 753 tons. Further, gold exports from India rose 62% from the April to August period. India's purchases of gold in September were 36.25 tons down from 39.76 last year, but up from 17.5 tons last month. Higher rural incomes and a stronger rupee have helped to lift gold demand. At a recent conference, the London Bullion Association indicated that gold would hit \$1450 over the next year. The downside risk to the market rests in a massive long. Non-commercial reporting positions showed a net long of 280,380 futures and options contracts. There

were 311,557 longs against 31,177 shorts a near 10:1 ratio.

Soybean prices will be focused on the U.S. harvest, South American weather, and demand trends. Moreover, the trade will be sensitive to the position of funds. Weather has been open in the Midwest allowing farmers to harvest and placing supply pressure on the market. Concerns over yield linger, but the market is comfortable with progress. Crop conditions were rated 63% good and excellent in late September, a number which is above the last few years. Weather patterns have also become wetter in South America and eased concerns over La Nina linked dryness and poor planting conditions. Large funds were long 203,601 futures and option contracts and short just 29,970 futures and options contracts as of September 28th. Funds were extremely long going into the stocks report September 30th and selling at the turn of September was probably a function of a shift in the fund long. The stocks report indicated that there were 151 mln bushels of soybean in storage up from 138 mln a year ago. On a more bullish note, export sales continue to be brisk. Sales were 1.73 mln tons in the week ending September 23rd which is on the higher end of the historical range.

Like soybeans, **corn** prices will focus on the results of the U.S. harvest, demand trends, and South American weather. The September 30th crop report was a shock to the market as corn stocks were estimated at 1.708 bln bushels well above the trade guess of 1.407 bln bushels. Some in the trade are skeptical of the increase, but the number caught the market off guard. There is a belief in the market that a significant amount of corn was harvested early, and found its way into the September number. Many top tier market watchers are discounting the report and believe supplies will continue to tighten in 2011. Weather has been favorable for harvest in North America, but there are concerns that yields could be disappointing and hold back production. The market has forgotten about

this idea in the wake of the stocks number, and funds have moved to cut excessive long exposure. The crop rating for corn has declined steadily through the crop year and stood at 66% in late September. Although the trend has been down, the conditions rating is still comfortably high. The fund long was huge in corn going into the September 30th stocks report. As of September 28th, large funds were long 553,500 futures and options contract and short 95,043 futures and options contracts. Export sales have cooled in recent weeks adding pressure to the market. Sales totaled 926,000 tons in the period ending September 23rd. However, the 4-week average declined to 689,000 tons which is the lowest since March.

Wheat prices will start to focus on the USDA's world supply/usage report October 8th. The September 30th report showed an increase in wheat stocks and could not feed a rally, which had been based on worries over tight global supplies. The USDA took its September 1st ending stock number to 2.459 bln bushels ahead of the trade guess of 2.440 bln bushels and last year's stock level of 2.209 bln bushels. Demand appears to be cooling. The USDA's September 30th report also displayed disappointing implied feed and residual usage. More tangible, U.S. export sales have slowed in recent weeks after a hot pace in August and early September. Additionally, the market has been talking about wheat being offered in Europe – a sign that supplies are not tight. The managed money long in the wheat market is long relative to the past few years, but the non-commercial reporting category showed a small net short position in the week ending September 28th.

Cotton prices will be driven by demand, and the outlook for production. U.S. export sales are hot and are at the upper end of the recent range. In the period ending September 23rd, cotton export sales were 830,000 tons. The strong pace of export is complemented by extremely tight ICE inventories. Stockpiles totaled 18,451 bales at the end of September. Stock levels are the lowest since at least 2002.

However, the International Cotton Advisory Committee predicted that cotton output would rise 16% in the new crop year to 25.2 mmts. Demand was projected to rise 2% to 25.1 mmts, but high prices are expected to lift plantings and output. Informa recently indicated that 2010 US production would be 19.431 mln bales up from a prior forecast of 18.823 mln bales. The major downside risk to the market rests in an excessive spec long and potential miss positioning for bearish news. As of September 29th, large specs were long 80,455 contracts and short just 6,081 contracts.

Cattle supplies are expected to tighten in October, and feed yards are current. Five months ago, placement numbers peaked and worked lower, setting the stage for tighter supplies in the coming weeks. Lean supplies are highlighted by weights. USDA steer weights were down 27 lbs from a year ago at 1290 lbs. The recent drop in corn prices in the wake of the USDA's stocks report will also keep feed yards from pulling cattle forward. The supply backdrop will provide support to the market. On the demand front, buying for mid October is expected to surface. The export market shows little sign of slowing, and the hide and offal value is \$1.91 above a year ago at \$11.20. The weakness in the dollar should be a benefit to exports. The main downside for demand rests in the high unemployment rate and cautious consumer attitudes.

Hog supplies will rise seasonally into mid November, but the hogs and pigs report provides a favorable backdrop. Supplies are tighter than a year ago. The September hogs and pigs report showed total inventories down 2.6% y/y. The breeding herd was off 1.8% y/y, while market hogs were off 2.7% y/y. September/November farrowing intentions were down 1.2% y/y, while December/February intentions were up just 0.5% y/y. Lower corn prices linked to the USDA's stocks report should reduce the need for hog producers to push supplies forward. Tight supply is highlighted by the dip in output

from a year ago. In the week ending October 2nd, slaughter and production were off 6.2% and 6.9% from a year ago. On the demand front, the end of BLT season caused pork belly prices to plunge in late September. Bellies declined \$26/cwt and weighed on cut out values. The weak dollar should help to support prices. One negative could be rising trade tensions. China recently slapped a tariff on U.S. poultry imports.

Coffee prices have weakened technically, but stock levels continue to be price supportive. Although the ICO forecast coffee production in the 2010/2011 season at 133 mln to 135 mln bags up from 119 mln bags in 2009/2010, inventory levels look lean. The ICO said that inventories in exporting countries stood at 11.9 mln bags compared to 20.9 mln bags a year ago, while inventories in importing countries stood at 22.3 mln bags compared to 21.4 mln bags last year. At the same time, the Director at Dak Lak Import-Export Investment Company said carry over stocks in Vietnam were probably less than 500,000 bags compared to 2.0 to 2.5 mln bags last year. He noted that higher prices led to farmer selling. Additionally, ICE coffee stocks continue to trend lower and stood at 1.96 mln bags in late September. Demand is strong but rising retail prices will provide a test. Starbucks said that it would make price adjustments on some beverages (larger more labor intensive drinks), but not an across the board increase. It will raise prices of packaged coffee to third party channels like groceries. However, Nespresso sales in the U.S. and Canada have increased 50% this year. Store openings and new distribution agreement have helped to lift sales, and show underlying demand for coffee products.

Sugar prices will focus on rains in Brazil and the outlook for increased Indian production. The sugar market is expected to move from deficit to surplus, but La Nina weather patterns have created dryness and threaten to reduce Brazilian sugar production. As a result, the surplus forecast may not stand. Highlighting

dry weather in Brazil, a recent wire story indicated that the Amazon River has shrunk to its lowest level in 47 years. More importantly, Cosen cut its cane crush forecast to 60 mmmts this year down from 62 mmmts. Likewise, next year's output was expected between 60 and 62 mmmts. Cosen recently stated that prices don't reflect the drought and could reach 30 cents. Ships continue to be backed up in Brazil and the bottleneck seems to be lingering. In the week ending September 29th, there were 107 ships waiting to be exports up four from the week prior. Looking to India, the National Federation of Cooperatives said that India's sugar surplus may rise 50% in the new crop year starting October 1st. The national surplus was projected at 7.0 to 7.5 mmmts up from a prior forecast of 5.0 mmmts. India's food Ministry projected that production would be 24 mmmts in the coming crop year. These statements are complemented by signs the shortage is abating. India will decide on ending its export curbs in November. Further, India's sugar trading ban was lifted on September 30th and India has cut the amount of sugar that must be sold by mills to the government at below market prices by half.

The **cocoa** market is expected to see a small surplus this year, and this is acting to cap prices. However, the market will be sensitive to the election in the Ivory Coast, and the chance that La Nina brings wet weather to West Africa. The election in the Ivory Coast appears on track with voter lists approved, but risk of unrest lingers and tensions could lead to a disruption in cocoa transport and production. The vote is expected October 31st. Heavy rains are reportedly knocking flowers off of trees in Nigeria, and highlight the potential adverse impact of weather. There is also chatter about wet weather leading to black pod diseases. Additionally, the head of Ivory Coast's Coffee and Cocoa Management board said that the Ivory Cost's October to March crop could fall 10% y/y. Lack of access to farming inputs like fertilizer was expected to restrain production. The market will also be hungry for Q3 grind numbers.

North America

The **U.S. economy** is growing slowly. Consumer spending continues to be muted, while business purchasing and hiring are cautious. The housing market is still working through an excessive supply of existing inventory and foreclosure activity is still high. The politic backdrop remains a headwind to confidence. Inflation is tame and the Fed is focused more closely on deflation risks. The Fed has opened the door to asset purchases and a second round of QE. A plan to buy assets could be announced as early as the November FOMC meeting. The **Canadian economy** is expanding, but a slower pace of global growth and recent data points suggest loss of momentum. Inflation is contained. The BOC will slowly work to normalize rates. Another 25 bp rate hike by year end has become less likely given comments from BOC Governor Carney. Key economic indicators:

U.S.:

- September Manufacturing ISM declined 1.9 to 54.4 (54.8 expected). Activity slowed, but the ISM is showing quicker growth than most of the regional surveys. Details displayed some worry that inventory levels could weigh on growth and the employment index eased.
- August Existing Home Sales rose 7.6% to 4.13 mln (7.1% or 4.10 expected). Single family and condo sales rose 7.4% and 8.5% respectively. Supply is elevated at 3.982 mlu. There was an 11.6 month supply. The median price rose 0.8% y/y with condos down 2.8% y/y and single family up 1.2%.
- August New Home Sales were flat at 288,000 (295,000 expected). There were 204,700 homes in inventory, a historically low level. The Median price fell 1.2% y/y.
- Housing starts rose 10.5% to 598,000 (550,000 expected). Multi-family starts rose 32.2%, while single-family starts rose 4.3%. Multi-family starts have picked up noticeably in the last few months and may be showing signs of a recovery. None-the-less, the level of activity is depressed
- August Retail Sales rose 0.4% (0.3% forecast) and 0.6% excluding auto (0.3% expected). Vehicles and parts fell 0.7% and have been choppy in the past 4 months. □ Building materials were unchanged after falling the past 3 months. Food rose 1.3%, electronics declined 1.1% for a second month, and eating and drinking sales rose just 0.1%. There has been no real change in eating and drinking sales since August.
- August Durable Good Orders fell 1.3% (1.0% expected). However, ex-transport orders rose 2.0% (+1.0% forecast). Non-defense capital good orders ex-air gained 4.1% and suggests the manufacturing sector is expanding.
- Realty Track said that bank repossessions rose 25% y/y in August to 95,634. Foreclosure filings fell 5% to 338,836. Foreclosure may add as many as 12 mln homes to the US market. Nevada and Florida had the highest foreclosures rates. Michigan, Illinois, and Arizona are also feeling stress.
- August CPI rose 0.3% m/m (in line). Core unchanged (0.1% expected). US inflation is tame. Housing was flat, apparel fell 0.1%, and food and beverage rose 0.1%. In contrast, transportation rose 1.2%.

Canada:

- July Manufacturing sales fell 0.9% m/m (0.2% expected). Sales have declined 2 straight months after strength in May. Activity has found a softer tone.
- July Retail Sales fell 0.1% m/m (0.6% expected). Vehicle sales rose 1.1%, but furniture, electronics, and building materials declined 8.4%, 4.9%, and 2.6% respectively.
- July Home Prices rose 12.4% y/y (Teranet). Price appreciation is matching the gains seen in 2006.

- August CPI fell 0.1% m/m. Year over year CPI rose 1.7% (1.6% expected). Core CPI rose 1.6% y/y (in line). The trend is flat and inflation is contained. On a sequential basis, healthcare and personal care rose 0.7%, but transportation, recreation and education, alcohol and tobacco, and shelter costs all declined.

Europe

*The **Eurozone** economy is expanding, but is running at two speeds with Germany, France, and the Netherlands performing strongly relative to Greece, Spain, and Ireland. Consumer spending is flat, but may be showing signs of improvement given confidence data. Business spending and exports remain the drivers of growth. A slower tone to global growth and a firmer tone in the euro risk slowing growth into 2011. Inflation is contained. The ECB will keep rates unchanged and continue to monitor the healing of the banking system and the work out of the sovereign debt crisis. The **U.K.** economy is on softer footing, but still expanding. Manufacturing activity has eased hurt by slower global growth, while housing demand has flattened. Consumer readings are uneven with the CBI displaying strong consumer spending, but official retail sales numbers were considerably softer. Fiscal and regulatory policy remains a headwind to growth and the effect may be showing up in labor data. Inflation remains uncomfortably high, but should moderate. The BOE appears open to expanding its QE program. Key economic indicators:*

Eurozone:

- September EZ Manufacturing PMI fell 1.4 to 53.7. Production rose across the EZ, but the rate was the slowest since October 2009. New order growth was the weakest since September 2009 with only France and Austria displaying improved growth. Spain, the Netherlands, Greece, and Ireland saw a contraction in new orders. Growth eased sharply in Germany and was flat in Italy. Job creation accelerated to a post recession high, but was modest. Germany, Austria, and the Netherlands posted job growth. France saw a small drop. Declines in job growth slowed in Spain and Greece, but layoffs were accelerating in Italy and Ireland. Input prices picked up and output prices rose for the sixth month and at the fastest pace in June
- September German IFO rose 0.1 to 106.8 (106.4 forecast). Current assessment rose 1.5 to 109.7 (108.7 forecast), while expectations fell 1.3 to 103.9 (104 forecast). Service climate rose 0.5 to 20.5 and is working higher. Manufacturing fell 0.2 to 20.0 showing a pause, but the overall trend is still upward. Construction increased 0.5 to -18.1. The improvement has stalled over the past two months Retail trade gained 2.2 to 11.4 and shows surprise improvement.
- September French Industrial Business Confidence was flat at 98. Production outlook increased 2 to 3 (-1 expected). Own company production outlook was up 5 to 0. Building confidence was unchanged at 95 and is flat to higher in recent months. Expected activity rose 3 to -10 and shows improvement. Order book was steady at 6.5.
- September French Retail Confidence increased 4 to 107 and is working higher. General outlook rose 6 to -19 and rising. Expected demand rose 6 to -1 which is firm. Employment trends were little changed.
- September French Service Confidence gained 1 to 99 and is flat since May. Future labor trends showed slight improvement, while recent labor trends rose 1 to 7 and have trended higher.
- August German unemployment fell 40,000 (-20,000 expected). The labor market appears healthy. Unemployment declined for the 15 month.
- August German Unemployment Rate fell 0.1% to 7.5% (7.6% expected). The recent trend is lower and the rate is testing the 2008 lows.
- September French Consumer Confidence rose 2 to -35 (-39 expected). There is a budding trend toward improvement after a spring lull. Unemployment fell 11 to 44 and is trending lower.

- September Italian Consumer Confidence rose 3.1 to 107.2 (104.0 expected). Confidence is recovering from its recent low, but is off the late 2009 high near 114.0.
- August French Consumer Spending fell 1.6% m/m (-0.2% forecast). There was across the board weakness. Autos fell 1.5%, textiles, plunged 6.1%, and household goods declined 0.3%. Sales have been choppy the last few months tracking up and down sequentially. The level of activity has been flat since February.
- July Spanish Housing Transactions rose 16.4% y/y. The sequential gain was stronger up 17.5%. The level of sales is flat to higher this year.
- September EZ CPI estimate was 1.8% y/y. Inflation is trending higher, but still below levels seen between 2002 and 2007. It is well off the 2008 peak over 4%.

U.K.:

- September Manufacturing PMI fell 0.7 to 53.4 – a 10 month low. Production rose, but the rate of expansion was the slowest since September 2009. Investment good production eased and weighed on output. New orders expanded, but at a pace below the average of the past 15 months. Export orders contracted. Employment rose slightly. Higher input costs were noted. Output prices were higher, but the pace of inflation eased to a six month low.
- September CBI Industrial Orders fell 3 to -17. The gradual improvement continues, but the level is still unexciting. Export orders declined 4 to -5. Volume of output rose 2 to 12, but has slowed from the spring. Average selling price was up 4 to 15, which is on the higher end of the range.
- August Mortgage Approvals fell 1,300 to 47,400 (47,000 expected). The trend is flat to lower.
- August retail sales fell 0.5% (+ 0.3% expected). There was general weakness with textile off 0.4%, household goods down 0.5%, food declining 0.5%, auto fuel falling 0.9%, and other stores down 2.1%. Non-store retailing rose 2.1%. Ex-auto fuel, sales taken a pause after strength between May and July. The index is still pitched higher over the past five months,
- September Retail CBI rose 14 to 49 (25 expected). 47% of firms expect higher sales volumes in October. Clothing and footwear and leather saw particularly strong sales growth. Sales were also called solid in furniture and carpets. Motor trade saw flat volumes to a year ago, but an improvement from the -21% the month prior. The CBI was looking for restrained spending in 2011 due to weak prospects for take-home pay.
- August Claimant Count rose 2,300 (-3,000 expected). Labor market conditions have softened in recent months. However, the number is back to the range seen between 2004 and 2007.
- August ILO Unemployment Rate was unchanged at 7.8% (in line).
- RICS home price balance fell 24 to -32 (-12 expected). Increased supply pushed prices lower. Lower prices were said to be boosting sales expectations, but nearly agreed sales fell 21 to -20. Expectations for sales rose 10 to 18.
- August CPI rose 0.5% m/m (0.3% expected). The gain reverses the decline in July. Clothing and footwear rebounded. Household firmed, and transport gained. Inflation is up 3.1% y/y and shows a moderating trend.

Asia

*Asian growth continues forward, but is being led more clearly by China and India. Korea, Australia, and Japan are displaying reduced growth. The **Chinese** government continues to engineer a soft landing. Measures to cool the property market are being implemented and have been accepted kindly by property stocks. Manufacturing activity has lifted from a pause, and lending activity is supportive to sustain growth. Weaker economies abroad and higher wage costs are the main risk to activity. Inflation is rising, but moves to cap property prices and weak economic conditions in the U.S. and Europe will help to restrain pricing power. Further, the government has allowed the yuan to firm in recent weeks, working to cheap raw material costs. The PBOC will lean toward hiking*

rates until inflation stabilizes. **India** shows solid growth, and monsoon rains should benefit rural incomes. Inflation is too high and the RBI will continue to tighten monetary policy. **South Korean** shows signs of slowing given the set back in the PMI and BOK survey of business. Trade data shows healthy growth but deceleration, and the global slowdown is spilling into the Korean manufacturing sector. Consumer confidence has eased slightly. Inflation is low but starting to work higher. The BOK will be biased toward raising rates, but will act slowly given overseas growth trends. The **Australian** economy is showing uneven growth. Strong commodity prices and strength in China are boosting growth. Domestic demand looks less impressive with the manufacturing PMI under 50, housing activity slowing, and consumer confidence falling. Inflation is contained and restrained by a strong Australian dollar. The RBA is biased toward raising rates, but will act slowly given domestic indicators and already normalized rates. Economic growth in **Japan** faces the headwind of a strong yen. Manufacturing indicators point to slower growth and the capital spending measure in the Tankan survey fell short of expectations. Domestic demand is far from strong, but household spending is high relative to most of the 2000's. The economy continues to face deflation. The BOJ will be biased toward easing until the yen cools. Key economic indicators

Australia:

- September Performance Manufacturing Index fell 4.4 to 47.3. The index has fallen sharply from the April peak of 59.8. New orders fell 4.1 to 46.5, employment dropped 6.5 to 44.8, and production fell 5.3 to 46.2. The data shows loss of momentum.
- August NAB confidence rose 9 to 11, but business conditions were unchanged at 5 and have displayed a softer tone in recent months. Trading fell 3 to 5, profitability rose 1 to 4, employment fell 4 to 3 and forward orders rose 2 to -6.
- August building approvals fell 4.7% m/m (flat forecast). Approvals have been extremely weak since March. Approvals peaked at 16,835 in March compared to 13,049 in August.
- August HIA New Home Sales fell 2.6% m/m. Sales have declined 4 straight months, and are below levels seen in January
- August Private Sector Credit Growth rose 3.1% y/y (2.9% expected). Credit growth is rising very slowly off a depressed level and trough in late 2009.
- July Conference Board LEI rose 0.8% to 120.0. The trend is higher and points toward growth. Westpac Consumer Confidence fell 5.0% m/m to 113.2. Shows signs of topping. It has recently been up against historical highs -2007 and 2005 peaks.
- DEWR Skilled Vacancies rose 0.1% m/m. The index level has been flat to higher since the spring. Job growth continues, but has a slower pace basis the index.

China:

- September HSBC Manufacturing PMI rose 1.0 to 52.9. Production rose, but the expansion was moderate and slightly faster than the long run average. New orders and export orders appear to have improved. Staffing numbers rose, but the rate of job creation was slight. Input costs rose substantially and inflation has re-accelerated steeply. Steel and raw material prices accounted for higher input costs. The rate of output inflation was sharp and the fastest in 8 months. Producers were trying to hold margins together. Looking at the series, the bounce off the 50 line hints the expansion is overcoming a normal dip and settling to a sustained pace. The picture will be clearer in a few months.
- September NBS/Federation of Logistics & Purchasing Manufacturing PMI rose 2.1 to 53.8. Output rose 3.3 to 56.4, new orders rose 0.6 to 52.8, and employment rose 0.7 to 52.3. The index is settling into a pattern of a maturing economic expansion.

- Q3 Banker Confidence rose 9.1 to 73.1. The level of confidence is high. The index was just 25.6 in Q1 2009. Banking climate was up 0.9 to 68.4 consistent with the gradual uptrend. Land demand was down 0.2 to 66.7. It has eased slightly, but is still high
- July LEI rose 0.7 to 147.6. The index continues to work higher.
- August New Yuan Loans were CNY 545.2B (CNY 500 expected) and lending activity should sustain growth.
- August CPI rose 3.5% y/y (in line). Food accounted for much of the increase and there is upward creep.

India:

- September HSBC PMI fell 2.1 to 55.1. The level of activity is consistent with conditions in late 2006 and early 2007 suggesting healthy growth. New orders rose markedly and supported higher output. However, employment fell for a third straight month. Employees leaving are not being replaced, but the decline in staff was called marginal. Input costs rose significantly, but output prices rose at a weaker rate with strong competition limiting pricing power.
- September 18th Primary Articles WPI rose 16.44% y/y. Inflation is off its peak near 23%, but remains elevated. Basing effects will provide some pressure to the inflation.

Japan:

- September Manufacturing PMI fell 0.6 to 49.5. New business fell for a second month, there was a slow rise in output, and input costs fell due to a strong yen. Further, staff levels declined for a second month and backlog declined. The PMI employment index is arguing for lower employment and a reduction in the growth rate of GDP.
- Q3 Tankan Large Manufacturing Index rose 7 to 8 (7 forecast). The index continues to work higher, but is below pre-crisis levels. A reading between 14 and 25 would be consistent with the expansion in the 2004 to 2007 period. Outlook rose 2 to -2 (-4 expected).
- Q3 Tankan Non-Manufacturing Index rose 7 to 2 (-2 expected). The trend is higher, but the index remains well off the pre-crisis highs. The index peaked over 20 in 2007 after working higher from the early 2000's. The Outlook index rose 2 to -2 (-4 forecast).
- Q3 Large All Industry Capex rose 2.4% (3.0% expected). The trend is weak.
- September Small Business Confidence fell 1.1 to 47.3. The trend is flat to lower in recent months and suggests stagnate growth. Both manufacturing and non-manufacturing sectors displayed weakness.
- August Exports rose 15.8% y/y (19.0% expected), while Imports rose 17.9% y/y (17.5% expected). The export volume index dropped sharply on a sequential basis. The import volume index rose 1.1 to 104.3.
- August Unemployment fell 0.1% to 5.1% (in line). Employed persons fell 10,000, while unemployed persons declined 70,000. Labor trends are uneven.
- August Jobs to Application Ratio was unchanged at 0.54 (in line). The ratio continues to inch higher showing very slow improvement in labor market conditions.
- August Retail Trade rose 1.4% m/m (1.9% forecast). Sales have risen over the past 3 months and the sequential trend points toward growth.
- August Household Spending rose 1.7% y/y (1.4% expected). Spending appears on firmer footing and flirting with peak levels seen during the 2000's.
- August Industrial Production fell 0.3% m/m (1.1% forecast). IP has now declined 3 months in a row and it looks like the high yen is starting to hurt growth. The seasonally adjusted index hit a peak of 96.1 in May and was 94.5 in August.
- August Housing starts rose to 829,000 (759,000 expected). Starts have improved in recent months, but remain below levels seen in March. The level of activity remains extremely depressed to the per-crisis periods (2004 to early 2007).

- August CPI fell 0.9% y/y (as expected). Deflation continues to grip the economy. Sequentially, prices fell 0.3% led by household, clothing, and medical prices. Prices have declined four of the past five months.

South Korea:

- September HSBC Manufacturing PMI fell 2.1 to 48.8. New orders declined and were pressured by weaker domestic demand. Net export business rose, but just marginally. Employment rose, but the gain was the weakest in 14 months. Input costs increased sharply due to higher raw material costs. Output prices rose, but at a much slower rate due to competition for new business.
- September BOK Consumer Confidence fell 1 to 109. Confidence is cresting from its June/July peak of 112. Spending plans are stable. Employment fell 3, but remained elevated to trend,
- August Industrial Production fell 0.6% m/m. There was across the board sequential weakness showing a slowdown in activity
- August Exports rose 17.2% y/y (15.7% expected). Export growth shows signs of decelerating, but remains at a high level. The base effect will start to drag on growth.
- August Imports rose 16.7% y/y. Import growth has eased. Import growth in the 10% to 20% range was the norm between 2003 and 2007.
- September CPI rose 1.1% m/m (0.4% expected). CPI rose 3.6% y/y and shows signs of increasing. Core CPI rose 1.9% y/y and is starting to work higher.

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