

U.S. equity markets took a breather yesterday with low trading transactions and implied volatility returning back below 20 % (VIX at 19.94 %). Worries about a tightening of both monetary and fiscal policies are calming down. Earnings are not a worry either since more than 85 % of S&P 500 index companies have reported Q4 earnings and 73.4 % of companies that have reported announced largely above estimates results. Q4 earnings will be around +85 %, the first quarter of increase since 2007. So, it's now time to have a look at how long term interest rates will be in the future.

Will China reduce its purchases of U.S. Treasury securities and will it send U.S. long term interest rates on the upside?

The FT titled about the U.S. TIC (Treasury International Capital) for December: Foreign demand falls for Treasuries: "Foreign demand for US Treasury securities fell by a record amount in December as China purged some of its holdings of government debt, the US Treasury department said. China sold \$34.2bn in US Treasury securities during the month, leaving Japan as the biggest holder of US government debt. China overtook Japan as the largest holder in September 2008". One can wonder what foreign demand is (these are net flows, so it could likewise be a product of domestic supply and/or demand), but foreign holdings of US Treasuries grew! In December, foreign holdings for US Treasury securities – official and private holdings of US Treasury bonds/notes + US Treasury bills – increased by \$17 bn over the month. China dropped its overall holdings, but the article fails to mention the shift in holdings by other key countries that offset completely China's sell-off. In December, the UK and Japan jointly increased their holdings by more than China dropped its holdings, + \$US 36.4 bn vs. -\$US 34.2 bn. And finally, China's current portfolio is really not that different from recent history. China's December share of US Treasury holdings, 20.9% (as a % of total foreign holdings), is barely off its 2007-2009 average, 21.4%. But Japan's holdings are way off, and could revert towards the average, 23.7%. The TIC can't tell us much about the outlook for U.S. Government bonds or what China will do next. The TIC system attempts to track cross-border financial flows between U.S. and foreign resident. The headline number reported each month is the net foreign buying of U.S. long term securities. This fell sharply from \$126.4bn in November to \$63.3bn in December. As it happens, it is not certain China has been a net seller: the TIC system would not pick up Chinese purchases of Treasuries from a U.K. bank or even from the London branch of a U.S. Bank. We have also seen these dips before and they have not been sustained: China's purchases of foreign assets will inevitably continue as long as China runs a current account surplus (data from the PBoC suggest that it bought another \$40bn of foreign exchange in December). Anyway, the upshot is that the fact that China may have reduced its buying of U.S. Treasury securities didn't send long term interest rates on the upside. They just rose slightly (10-year T-Note rate hiked from 3.69 % to 3.79 % last week) after the Fed announced its Discount Rate hike.

Will soaring deficits boost rates?

The behavior of U.S. interest rates since the crisis of October 2008 and the sharply higher government spending that followed is broadly consistent with survey's findings on the impact of enlarged, expected future deficits and debt upon forward rates on ten-year notes. A 20–25 percentage-point rise in the debt-to-GDP ratio after the 2008 fiscal year probably added about fifty to seventy basis points to longer-term yields as a reflection of the implied rise in forward ten-year rates. That effect appears to have arisen largely after the rebound from the March 2009 negative spike in interest rates tied to the initiation of Treasury purchases by the Federal Reserve. Additional slippage on the outlook for deficits and debt would boost rates further. An additional \$100 billion deficit per year, which would translate into a \$500 billion rise in debt five years from now, would add another ten to fifteen basis points to yields on Treasuries. While the increase in Treasury yields is undesirable and discourages private borrowing, it is hardly catastrophic, as some analysts have suggested. The reality is that buyers of Treasury notes can foresee the impact of higher deficits on the stock of outstanding debt in the future. In effect, that impact is already in the price. Viewed another way, were it possible to undertake measures to accelerate growth or cut spending to substantially reduce expected future deficits and debt, Treasury yields could be expected to come back down and thereby enhance the prospects for a higher level of private-sector borrowing and spending.

After session yesterday, Nordstrom (-3.50 %) and RadioShack (-4.75 %) missed analysts' estimates. This morning (06.30 GMT) U.S. index futures are slightly up: DJIA +0.08 %, S&P 500 +0.05 %, Nasdaq 100 +0.06 %. Asian markets were mixed with the Nikkei down 0.47 %, Shanghai down 0.96 % and Hong Kong up 1.09 %. European markets could open slightly higher.

	WTI	€/€	\$/¥	10 yr US	10 yr Euro	Basic	Energy	Financ	Health	Tech	Tel	Indus	Utilities	SOX	S&P	NAS	DOW	Close
Last	80,0	1,3628	91,04	3,79	3,27	-0,29	-1,34	0,99	-0,07	-0,27	-0,20	-0,02	-0,51	-0,29	-0,11	-0,08	-0,18	US
Perf 1d %	-0,18	0,24	-0,13	-0,57 bp	-1,5 bp	-0,36	-1,45	0,62	-0,10	-0,44	-0,24	-0,12	-0,27	-0,48	-0,22	-0,24	-0,17	Europe

ECONOMIC DATA with impact

Reporting today: Home Depot, Macy's, Target before the opening.

U.S. Treasury auction: 2-year note, \$44bn.

In the U.S., watch for the **Conference Board Consumer Confidence Index** for February (15.00 GMT) expected at 55.0 vs. 55.9 in January and 55.3 in December. This move is likely to primarily reflect the recent decline in equity prices. /Major

The **S&P CaseShiller Home Price Index** (14.00 GMT) is expected flat. in December at 146.3 in November, while the **S&P CaseShiller composite 20 YoY** may have improved to -3.0 % in December from -5.3 % in November. /Major

The **Richmond Fed Manufacturing Index** for February (15.00 GMT) is expected at +1 following -2 in January and -4 in December. /Minor

In the Euro zone, watch for the **German IFO Business Climate Index** for February (09.00 GMT) expected at 96.1 vs. 95.8 in January. The current assessment is expected at 91.9 vs 91.2 in January and expectations at 100. vs. 100.6 in January. The IFO index should point to a modest recovery while the euro-zone composite PMI (released on Friday 19th) was unchanged in February. /Major

POSITIVE IMPACTS

NOKIA, ERICSSON : Gartner said it expects cellphone mkt vol to grow strongly in 2010 as economies improve .

CBK : Q4 NII €1.89bn (€1.75bn exp) / **Net Comm income €972m** (€940m exp) / **Loan-Loss Provisions €1.32bn** (In line) / **Operating Loss €1.57bn** (€1.15bn exp) hit by a Trading Loss of €561m (€210m exp) / **Tier1 10.5%** / Says Monoline exposure reduced significantly / Sees Op. expenses at high levels in 2010 / sees significantly improved group result in 2010 & Loan-loss provisions back to 2008 levels

GLAXOSMITHKLINE is to create 1K jobs in the U.K. in response to a special tax regime for patents, known as the "patent box,"

ASTRAZENECA reaches pact with UK Tax authorities over transfer pricing / Increased its 2010 tgt for core EPS to \$5.90-6.3 (from \$5.75-6.15) / To pay £505M to HMRC to resolve all claims

VIVENDI bought 5.1% stake in Canal Plus France from M6 for €384.2M boosting its total holding to 80%

LUFTHANSA: Pilots are halting a strike over competition from lower-paid non-German crews

SANTANDER is selling a 2.5% stake in **Bolsas y Mercados Espanoles** at €20 to €20.5 per share (Bloomberg)

DRAX : FY Rev £1.48bn (€1.35bn exp) / **Ebitda €355m** (€344m exp) / **Operating £173.2m** / revised policy to target 50% pay-out of underlying earnings effective from 2010 onwards/ **DPS 9.1P** (10.9 est)

NEGATIVE IMPACTS

HEINEKEN : 09 REV €14.70Bn (14.77 est) / **09 EBIT €2.095Bn** (2.10 est.) / **DPS €0.65** (0.63 est) / **Adj Net €1.05Bn** (1.02 est) / Expect further organic decline in the nber of employees / Capex 2010 will be in line with 09 / Prices increase in 2010 below levels of 09

CARLSBERG : Q4 Sales DKK 13.6Bn (14.2 est) / **Q4 Op Pft DKK 1.64Bn** (1.7 est) / **DPS DKK3.5** (4.5 est) / **Net pft DKK 383M** (555 est) / Mid term Op margin tgt for East Eur. Biz at 26-29% (prev.23-25%), for Northern & West Eur. 15-17% (prev.14-16%)

MERCK KGAA : Q4 Rev €2.03Bn (2Bn est) / **Q4 Core Op result €258M** (309 est) / **Q4 Net pft €56.7M** (99 est) / **DPS €1.00** (1.5 est) / Sees core Op pft growth of 3-13% in 2010

Q-CELLS : Q4 Sales €251m (€315m exp) / **Adj EBIT loss €20m** (€-27m exp) / Reiteratess sees positive market signals for H1 2010 / has no concrete plans to cut jobs this year

GDF SUEZ said it "has not as yet" contacted the French energy regulator for permission to raise household gas prices

EDF may use power assets and cash to buy a €1.6bn stake in Edison (Reuters citing sources)

IBERDROLA will seek approval from shareholders to create new shares valued at €1.87bn for dividend payments.

BRITISH AIRWAYS faces its first strike in more than a decade after the company's 12k cabin crew voted to stage a walkout in a dispute over staffing levels

AXA & National Australia Bank 's talks to buy & split up Axa Asia Pacific are taking longer than anticipated as they seek to resolve possible regulatory hurdles. Cos, which had expected an agreement for this month, now plan to complete the deal in March (BBG) .

ALLIANZ : The U.S. Supreme Court rejected PIMCO appeal, allowing a lawsuit to proceed that seeks more than \$600M in damages

SIEMENS may drop its plan to sell its hearing aid biz due to big differences over expected price between the German industrial conglomerate and potential bidders (Reuters)

METRO, ADIDAS, PUMA: The situation in Germany's retail industry remains difficult this Y & possibly also in 2011, the managing director of retail association HDE (Reuters)

	RESULTS	DIVIDENDS	EVENTS
Today	EU \ Carlsberg / Heineken / Iberdrola renovables / Merck KGaA / Vallourec US \ Home Depot / Office Depot		Goldman Sachs Technology and Internet Conf
Wednesday	EU \ Accor / Acciona / Cadbury / CNP Assurances / Commerzbank / Dexia / DSM / Ferrovial / Fresenius SE / Iberdrola / Mediobanca / Rhodia / TSM / Tenaris / Valeo	Land Securities (GBp 7,00) / QUALCOMM (\$0.17)	
Thursday	EU \ ACS / Aegon / Allianz / BASF / British American Tobacco / Centrica / CGGVeritas / Credit Agricole / Club Mediterrane / Deutsche Postbank / Deutsche Telekom / Dexia / Eiffage / France Telecom / Grifols / Henkel / Merck KGaA / Natixis / OMV / RBS / Red Electrica / Repsol / RWE / Saint Gobain / Safran / Segro / Suez Env / Sulzer / Telecom Italia / Voestalpine US \ Heinz Asia \ OZ Minerals	McDonald's (\$0.55)	JPMorgan Chase investor day
Friday	EU \ Acciona / Acerinox / Bayer / Belgacom / Endesa / Gamesa / Gazprom / Gecina / Lloyds / Parmalat / Petrobras / Sacyr Vallehermoso / Sol Melia / Telefonica US \ Novell	Goldman Sachs (\$0,35)	Novartis AGM
Monday	EU \ HSBC / Pearson / Vivendi		TMT conf at Morgan Stanley

TRADING IDEAS

BUY CAC INDEX & ALCATEL to play Island & reversal Head & Shoulder possibility

BUY Oil names as **TOTAL / ENI / ROYAL DUTCH** to play reversal Head & Shoulder on this names + upside trend

BUY LAFARGE on double bottom

BUY MICHELIN / RENAULT / ALSTOM / EON on reversal Head & Shoulder possibility

BUY LAFARGE / SELL HOLCIM So feared figures of Lafarge behind us nice prospect for 2010 + strong dividend yield (2€ ex date 07/01/2010) Holcim figures on third of March should now be feared // **BUY DAIMLER / SELL BMW // BUY ALSTOM / SELL SCHNEIDER // BUY AIR FRANCE / SELL BRITISH AIRWAYS // BUY METRO / SELL UNILEVER**

BROKER METEOROLOGY

ADP **RAISED TO BUY FROM HOLD** **BY CITIGROUP**

ANTENA3 **RAISED TO NEUTRAL FROM SELL** **BY GOLDMAN SACHS**

WENDEL **RAISED TO BUY FROM NEUTRAL** **BY UBS**

AKER SOLUTIONS **RAISED TO NEUTRAL FROM REDUCE** **BY NOMURA**

ACERGY **RAISED TO NEUTRAL FROM REDUCE** **BY NOMURA**

PETROLEUM GEO SERVICES **CUT TO REDUCE FROM NEUTRAL** **BY NOMURA**

PLEASE FIND BELOW ON THE NEXT PAGE OUR MORNING ECO

CHART OF THE DAY

EURO/USD
Since 2009



Source: Bloomberg

The EURO decline to 1.36 USD the lowest level since May 2009. The high level of uncertainty regarding the euro area mainly due to the Greek debt issue led the euro down. On the other hand the Euro area must do some fine tuning as it should avoid to high interest rate to save the Greece but leave some uncertainty in order to continue to push the EURO down. As the US are recovering and as the GDP should reach at least 3% in 2010 we forecast that the EURO will drop to 1.20 USD in a year./JB

Time	Country	Indicator	Period	GE forecasts	Consensus	Previous
7.45 GMT	France	Consumer spending	January		-1,1%,+3,6% YoY	+ 2,1%,+ 5,9% YoY
7.45 GMT	France	Consumer price index	January	- 0,2%,+1,1% YoY	-0,3%,+1,1% YoY	+ 0,3%,+ 0,9% YoY
9.00 GMT	Germany	IFO business climate	February	95	96,1	95,8
9.00 GMT	Germany	IFO current assessment	February		91,9	91,2
9.00 GMT	Germany	IFO expectations	February		100,5	100,6
14.00 GMT	United-States	S&P/CS Composite-20	December		-3,0% YoY	-5,3% YoY
15.00 GMT	United-States	Conference Board consumer confidence index	February	57	55,0	55,9
15.00 GMT	United-States	Richmond Fed manufacturing activity index	February			-2
22.00 GMT	United-States	ABC consumer confidence	February 21th			-49

Indexes	Price	% 5 Days	Ytd
DJIA	10383,4	2,93%	-0,43%
S&P 500	1108,0	3,08%	-0,64%
Nasdaq	2242,0	2,74%	-1,20%
CAC 40	3756,7	4,11%	-4,56%
DAX	5688,4	3,22%	-4,52%
Eurostoxx 50	2778,1	3,52%	-6,30%
DJ 600	249,7	3,26%	-1,66%
FTSE 100	5352,1	3,73%	-1,12%
Nikkei	10352,1	3,87%	-1,84%
Shanghai Comp	2974,9	2,32%	-9,22%
Sensex (India)	16280,4	1,24%	-6,78%
MICEX (Russia)	1353,8	3,75%	-1,19%
Bovespa (Brasil)	67184,2	1,60%	-2,05%

Forex	Price	% 5 Days	Ytd
EUR/USD	1,3625	-1,05%	-4,86%
EUR/JPY	124,03	0,07%	-7,39%
USD/JPY	91,03	-0,98%	-2,19%
Oil	Price	% 5 Days	Ytd
Brent \$/b	77,9	3,55%	0,87%
Gold	Price	% 5 Days	Ytd
Gold \$/oz	1115,9	-0,33%	1,72%
Rates	USA	Euro	Japan
Central Banks*	0,25	1,00	0,10
Overnight	0,01	0,32	0,10
3 Months	0,09	0,29	0,20
10 Years**	3,78	3,27	1,35

*US: Fed Funds; Jap: Overnight; Euro: Refi

** Euro: German Bund rate Source : Bloomberg

ECONOMIC DATA PREVIEW

Watch in **THE UNITED-STATES** the Conference Board consumer confidence index for February released at 15.00 GMT. After being up for two consecutive months, the Conference Board consumer confidence index increased again in January to 55.9. This leading indicator of household consumption should rise again in February and reach 57.

Watch in **THE EURO AREA** the Ifo business climate for February for February released at 9.00 GMT. After being up for nine consecutive months, the Ifo index rose in January to 95.8, the highest since July 2008. However the German economic recovery remains fragile as showed by the weak industrial production. Therefore we forecast a slight decline in the Ifo index for February to 95./**JB**

ECONOMY

UNITED-STATES : CHICAGO FED ACTIVITY INDEX IS BACK IN POSITIVE TERRITORY

After declining at -0.58 in December the Chicago Fed National Activity Index (CFNAI) increased in January and +0.2. This index is back in positive territory for the first time since July 2007. All the "growth motors" (especially investment and consumption) are on in the United-States and the virtuous circle of "investment, employment, consumption" is definitely back on track. Meanwhile inflation remains widely under control as showed by the core CPI reaching 1.6% YoY in January meaning below the 2% Fed'target. Therefore the Chicago Fed National Activity Index rebound is quite logical as it measures the current state of economic activity and inflationary pressure./**JB**

