HIGHLIGHTS

- **Dollar lost ground, hurt in part by report of $2.2 bln loss by Fannie Mae that reignited concerns about the general health of the financial system. In our view, the Fed made it quite clear with its expanded TAF and TSLF programs that credit markets are not yet back to normal, and so markets should be expecting more bad news from time to time. Despite the setback, we feel technicals still point to continued dollar gains. BOE and ECB meetings this week are not expected to yield any rate changes, but will nevertheless be closely watched for any subtle shifts in stance. Some analysts are looking for a 25 bp cut by BOE, but we think this is unlikely. Dollar/yen is still trading in a 103.50-105.60 range, and we think the recent drop provides a good opportunity to go long dollars (see below). The biggest winners against the buck on the day were CAD, TRY, NZD, ZAR, and SKK. Commodity currencies boosted by rising commodity prices again, while high yielders gained despite what could be seen as a return of some risk aversion. Bank Indonesia surprised with 25 bp hike, more hikes to come.**
- **US equity markets ended up on the day. Oil-related stocks outperformed, as oil prices made another record high above $122, helped by US investment bank forecast for $150-200. Financials also outperformed despite news of FNMA loss and big job cuts at Swiss bank. Asian ADRs rose during North American trading, pointing to a good start for regional stocks today, while Nikkei futures point to a higher open for Japan equities.**
- **US bonds were mixed on the day, with the 2-year yield down 5 bp and the 10-year yield up 3 bp. European bonds were up, with 10-year yields down 7 bp in UK, down 2 bp in France, and down 3 bp in Germany. Market still pricing in small odds of another 25 bp cut this year. Prior to FOMC, rate was seen bottoming at 2%.**

CURRENCY MARKETS

The dollar gave up ground against the yen but the factors thought to be behind this move are unlikely to have a lasting impact. One factor thought to be driving the move is an increase in risk aversion after Fannie Mae announced a $2.2 bln net loss in Q1. Yet the VIX index is up just 0.6% from the year's low hit on Friday while credit default swaps widened a net 2 bp, making it hard to argue that the equity and swap markets see a sharp jump in risk. Another factor that may have contributed to a firmer yen are reports Japan may exempt repatriated funds from taxes. We think this is unlikely. Japan's economy stands on a couple of legs, one of which is exports. Exports have already slowed and a policy that would help bolster the yen could have negative consequences for growth. The fundamental picture has not changed significantly since Friday when the dollar hit a two month high vs. the yen. The dollar's pullback after failing to make a clear break above the 100 day moving average (currently around JPY105.50) and the absence of further positive US news has helped push the dollar to the uptrend line drawn off the March lows around JPY104.00. The correction provides a US dollar buying opportunity with a stop below JPY104.00, as the market is likely to retest the recent US dollar highs.

Better than expected Canadian Ivey PMI survey for April (57.6 vs. 54.0 exp) is weighing on the US dollar but dips toward the 100 day moving average around CAD1.0060 provide US dollar buying opportunities. The data do not alter the outlook that softness in the US is acting as a drag on the Canadian economy, with exports likely to slip in coming months. The unexpected drop in March building permits, which fell 4.5%, reinforces concerns about a slowing Canadian economy. Building permits have declined in five of the last six months. With Canadian inflation relatively subdued, and with some risk of a contraction in the US economy during Q2, the Bank of Canada is likely to live up to its hints of a medium term rate cut. Indeed, a sharper than expected deterioration in the US economy could trigger a rate cut at the next BOC meeting on June 10th. One argument against Canadian dollar weakness has been the strength in commodity prices. Yet there is little sign of an increase in the correlation between the Canadian dollar and oil, natural gas or gold. Indeed the correlation to natural gas is close to zero and is less than 0.4% against oil and gold. This recent US dollar decline thus provides a buying opportunity. The dollar has remained in a CAD0.9775-CAD1.0325 range since mid-March when the Fed instituted new policies to help the credit markets and cut rates, and we feel that the US dollar is more likely to break to the upside than the downside.

Malaysia central bank meets May 26, and the last move was a 25 bps hike to 3.5% in April 2006. We note that the central bank said last month that rate hikes aren't very effective at limiting inflation in current circumstances. Governor Aziz noted that "The increase in prices is due to structural developments that relate to supply conditions that are not able to meet demand. Interest rates are not the answer in this kind of environment and these conditions." No change in policy is expected this month, but we note that inflation (2.8% y/y in March) has been kept artificially low as the CPI basket consists largely of goods with regulated prices. The government is taking a big fiscal hit from the implicit subsidies given to its citizens, and at some point, prices will have to be adjusted upward to better reflect market conditions. GDP growth remains strong (7.3% y/y in Q4) while the current account surplus remains wide (15% of GDP forecast for 2008). Our FX model identifies Malaysia as having very strong fundamentals. USD/MYR has been in a down channel since depegging back in July 2005, and bottom comes in around 3.12 currently. From a long-term perspective, charts point to retest of pre-Asian crisis low of 2.486.

Philippines inflation accelerated to a much higher than expected 8.3% y/y in April from 6.4% y/y in March, and is the highest rate since May 2005. The inflation target range is 3-5% for this year and 2.5-4.5% in 2009, and the central bank warned this month that the 2008 target is "clouded with risks." The central bank next meets June 5, and it last cut rates in January by 25 bps to 5.0%. We believe that a rate hike is likely in June given recent inflation trends, with core inflation up 5.9% y/y vs. 4.8% y/y in March. Besides rising inflation, the economy remains strong, with GDP up 7.4% y/y in Q4, same as in Q3, for a full year rate of 7.3% vs. 5.5% in 2006. Strong remittances from overseas workers continue to underpin the current account surplus, but underlying fundamentals are amongst the weakest in the region, reflected in large part by high debt ratios. PHP has underperformed in Asia, falling -2.5% year-to-date vs. the dollar. Near-term target is 42.918, the 38% retracement of the Aug 2007-Feb 2008 fall in USD/PHP. 50% comes in at 43.75, which we could see in H2.

UPCOMING ECONOMIC RELEASES

Taiwan Apr trade out, followed by UK Mar IP, eurozone Mar retail sales, German Mar factory orders, and Chile Apr trade. Czech central bank holds policy meeting. For US, weekly mortgage applications, Q1 nonfarm productivity, and Mar pending home sales are due out. Fed's Kroszner and Treasury's Paulson speak.

RATES AND RANGES -- at 16:00 ET/21:00 GMT

FROM NY OPEN			INTRADAY RANGES	
MAJORS	**16:00/20:00**	**% Change**	**LOW**	**HIGH**
EUR/USD	**1.5523**	0.2%	1.5453	1.5594
USD/JPY	**104.71**	-0.1%	104.02	105.13
USD/CHF	**1.0520**	-0.1%	1.0428	1.0551
GBP/USD	**1.9732**	0.1%	1.9636	1.9773
EUR/JPY	**162.55**	0.1%	162.01	162.79
EUR/GBP	**0.7867**	0.1%	0.7847	0.7891
EUR/CHF	**1.6331**	0.0%	1.6257	1.6335

COMMODITY CURRENCIES		% Change	LOW	HIGH
AUD/USD	**0.9501**	0.3%	0.9433	0.9502
NZD/USD	**0.7924**	0.8%	0.7844	0.7937
USD/ZAR	**7.5033**	-0.8%	7.4909	7.6090
USD/CAD	**1.0028**	-1.0%	0.9999	1.0146

FROM NY OPEN			INTRADAY RANGES	
OTHER ASIA	**16:00/20:00**	**% Change**	**LOW**	**HIGH**
USD/TWD	**30.43**	-0.1%	30.42	30.51
USD/PHP	**42.27**	0.5%	42.07	42.37
USD/THB	**31.73**	0.3%	31.57	31.80
USD/IDR	**9225**	0.1%	9204	9261
USD/MYR	**3.1490**	-0.2%	3.1455	3.1571
USD/SGD	**1.3587**	0.0%	1.3569	1.3612

FROM NY OPEN		% Change	INTRADAY RANGES	
LATIN AMERICA & NON EU EUROPE			**LOW**	**HIGH**
USD/MEX	**10.5050**	0.3%	10.4662	10.5077
USD/BRL	**1.6600**	0.4%	1.6520	1.6674
EUR/CZK	**25.20**	0.2%	25.12	25.23
EUR/PLN	**3.4367**	-0.2%	3.4338	3.4525
EUR/HUF	**251.92**	-0.1%	251.53	252.83

MONEY MARKETS (3 MTHS)	LEVEL	SPREAD
U.S.	2.83%	---
Euro	4.84%	202bp
Japan	0.86%	-197bp
U.K.	5.77%	295bp
Canada	3.44%	61bp
Australia	7.85%	503bp
New Zealand	9.00%	618bp
Switzerland	2.66%	-16bp

BENCHMARK EQUITY INDICES				
INDEX	**LEVEL**	**1 - DAY**	**Y/Y**	**Y/Y (US$)**
MSCI - World*	390	0.4%	-1.5%	-1.5%
MSCI - Europe*	563	-0.2%	-3.9%	-3.9%
MSCI - EAFE	2167	0.1%	-3.9%	-3.9%
MSCI - Asia Pacific	152	0.3%	3.4%	3.4%
MSCI - Emerging Mkts	1216	0.5%	22.2%	22.2%

AMERICAS EQUITY MARKETS				
INDEX	**LEVEL**	**1 - DAY**	**Y/Y**	**Y/Y (US$)**
Dow Jones Industrials	13026	0.4%	-1.8%	-1.8%
S&P 500 Index	1418	0.8%	-5.8%	-5.8%
Nasdaq Composite	2483	0.8%	-3.5%	-3.5%
Canada Toronto TSE	14417	1.0%	4.7%	15.1%
Mexico Bolsa Index	31230	0.9%	4.1%	7.3%
Brazil Bovespa Index	70069	-0.2%	38.5%	68.4%

EUROPEAN EQUITY MARKETS				
INDEX	**LEVEL**	**1 - DAY**	**Y/Y**	**Y/Y (US$)**
Eurotop (FTSE)	2833	-0.5%	-13.9%	-1.7%
FTSE Index	6215	0.0%	-5.9%	-6.8%
German DAX Index	7017	-0.5%	-6.6%	6.5%
French CAC 40 Index	5041	-0.4%	-16.9%	-5.2%
Italy MIB30	34929	-0.5%	-20.2%	-9.0%
Swiss MP Index	7544	-1.5%	-20.2%	-8.1%

COMMODITY MARKETS	Level	Previous	Change
NYMEX crude (near future)	$121.90	$119.97	$1.93
Gold (near future)	$877.80	$874.10	$3.70

BOND MARKETS	Level	Previous	Change
US 2-yr Note	2.37%	2.42%	-0.05%
US 10-yr Note	3.90%	3.87%	0.03%
US 30-yr Bond	4.64%	4.60%	0.04%
German 10-yr Bund	4.13%	4.16%	-0.03%
UK 10-yr Gilt	4.67%	4.74%	-0.07%
Canada 10-yr Bond	3.67%	3.63%	0.05%

MARKET INDICATORS	Level	Previous	Change
VIX Index	18.31	18.90	-0.59
EMBI+ Sov. Spread (prior close)	252bp		

*Source: Bloomberg. *These are the 'All Country' World & 'All Country' Europe indices, which cover developed and emerging markets for the respective regions.*