Views from the Trading Floor December 13, 2016

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A dominant thread in the trades below is countertrading. There are now more FI buyers than sellers (a big switch from Q3 Favorite Trades), and there are a lot of sellers of equities. The exception is in currency markets, where the Euro remains a popular short and the USD is still a popular long (check also the combo trades). An SG captured the thought process: 'Thesis is Trump in first 100days in office will step up negative rhetoric towards China, which induces a shock to a market leaning long equities and short bonds.' It's certainly possible, and the sequence of how policy initiatives are rolled out will surely matter. The assumption has been that Trump will be smart and engage in stimulus first before taking on much more controversial and potentially disruptive trade policies. Maybe not!

And, there's a sense in some of the comments below that Q1 in 2017 will be like 2016. The FED are again poised to hike while the ECB and BoJ are still committed to low for long. And, there's a sense that the CNY faces renewed outflows of capital. Remember the argument at this point last year that even a small FED hike would tip the world back into deep deflationary dangers? The 1937 analogue. Yet, things are different now with globalization under genuine threat and with the likelihood of fiscal stimulus ahead. Sure, there should be a correction along the way. And, sentiment and prices have shifted a long way in a short period of time.

But, so too has the underlying reality. We are not secure in the features of this new reality, for sure. And there are many dangers. But, it does seem like the forces are much more inflationary now than at this time last year. That is, it's suddenly more like 1939/1940 than 1937. And, during the 1940s QE was a policy designed to hold down yields as reflation took hold, rather than a policy to pull them down in an attempt to stimulate growth in a deflationary environment. That may be repeated.

The good news is that all this has generated considerable volatility, which is helpful for our businesses. Let's hope that this aspect, at the very least, continues into the New Year. I wish you all a very happy and restful holiday period; next year should be lively! -- Andres Drobny

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MANAGER FAVORITE TRADES FOR Q1 2017

1) Fixed Income

SG#1: ***Buy US 30Y Treasury:*** Soft patch in growth for both the US and China in Q1 might cause bond yields to give back some of their gains.

SG#2: ***Buy 10Y UST:*** Rates should top out in January and revert back to lower levels once the Trump euphoria fades. The market will be underweight fixed income and the first wobble in risky markets will cause a major rally.

SG#3: ***Buy the Dip in Treasuries:***

SG#4: ***Buy US Duration:*** It is unlikely we have seen a dramatic end to the 30yr fixed income rally…..we will likely consolidate sideways for a number of years as we did following the Great Depression when bond yields didn't bottom until 1941.

SG#5: ***Buy 30yr UST:*** Good carry and ongoing volatility.

SG#6: ***Buy TYG7 125-126 call spread at 14/15:*** Cheap way to fade the sell-off looking for a retracement start to the year. Talk Trumponomics all you want, we have only a limited idea of what that means……and….foreign demand is still strong. Alternatively, the 2s5s10s fly is also a nice way to fade.

SG#7: ***Buy EDM7-EDM8 Flattener:*** Market is too far ahead of FOMC. First half growth should be soft due to move in USD and rates, spec positions at record short, and China tensions rising like a year ago. Market sees good Trump; bad Trump is a risk.

SG#8: ***Buy IRH8:*** Market builds in almost 2% rate in Mar18 with current rates at 1.5% and RBA might actually cut again.

SG#9: ***Buy Greek Bonds:*** On their inclusion in ECB QE. Whilst soft taper has been announced, it is still E60bn per month and the supply of currently qualifying/purchasable securities is limited.

SG#10: ***Buy MXN 5yr Notes:*** This is part of a Buy EM strategy. The currency has gone from 17-20, interest rates are up 400bps. There is unlikely to be big tariffs coming and oil prices coming back will be big for Mexico now that Pemex has been fixed.

SG#11: ***Receive Front End Rates in MXN:*** Hikes won't materialize as growth halts and already at the high end of inflation expectations. Currency likely to finally stabilize.

SG#12: ***Receive DI Jan 21 (11.80):*** BCB credibility is fully restored and inflation expectations at the target in the relevant time frame. Current inflation is running at much lower levels than expected a few months ago and economic activity taking longer to pick up than expected. Despite political turmoil, Temer government has been able to pass reforms. DI prices in a lot of risk premium.

SG#13: ***Receive DI Jan 19:*** BCB is likely to accelerate rate cuts as output gap at historical highs and inflation moderating.

SG#14: ***Receive DI Jan 21:*** Inflation falling like a stone and BCB will need to over-deliver on cuts.

SG#15: ***Buy BNTNB 6% 2050 (BRL inflation linked bond):*** A weak economy undergoing fiscal consolidation with falling inflation rates needs monetary accommodation. Unlike prior downturns, the state run banking system is constrained which should cause market rates to come down sharply.

SG#16: ***Buy Brazilian Inflation linked bonds:*** Fundamentals are improving, prices are good in historical terms and central bank on the verge of a deeper interest rate cut process.

SG#17: ***Buy 10yr UST vs 10yr France:*** Spread is at an all time high and stretched due to expectations of Trump reflation and disconnect from Eurozone fundamentals. This trade is convex to both risk-on and risk-off. A continuation of US reflation will eventually force EUR rates to sell off in sympathy but, if US reflation once again proves to be just another false start, the spread should fall back to previous trading levels. Additional bonus is exposure to Eurozone political risk.

SG#18: ***Buy JPY 10s-30s Steepener:*** Tapering is in the air; it's a global thing. Japan moves the peg and curve adjusts steeper.

SG#19: ***Buy MXN TIIE 2-10yr Steepener:*** There's many problems that still need to be addressed and the economy is weak.

SG#20: ***Buy USD 2y Fwd 5-30 Steepener:*** The FED is likely to remain gradual before Trump announces his fiscal plan in detail. The expectation of fiscal stimulus and a stronger economy will continue to put pressure on the long end of the curve.

SG#21: ***Buy US Long Dated Inflation BreakEvens:***

SG#22: ***Sell 10yr US Notes:*** Rare to say it, but US election changed everything. Faster growth and tax changes will raise rates.

SG#23: ***Pay 10yr UK Rates:*** Trades 100bps tight to UST with poor C/A position, poor fiscal position, and weak inflation fighting credentials of the CB.

SG#24: ***Sell 30yr Real Rates in Canada:*** The QE experiment is in the 7th or 8th innings globally, term premium is very depressed everywhere and global growth is picking up. Time for the Long BE trade to pass the baton to short real rates. At 0.55%, Canada 30yr real rates are the epitome of that richness.

SG#25: ***Sell Long Dated Real Rates in the UK:*** They are deeply negative which makes no sense in a reflationary environment.

SG#26: ***Sell 10yr BTPs:*** ECB seems reluctant to change QE capital key rules and seems to be encouraging steeper curves. Oh, and the 'Italy is a huge mess' angle seems like a non-zero probability that the endgame is a write down on Italian debt.

SG#27: ***Sell 10yr Italy:*** The credit is mispriced given (1) populist gravitational pull; (2) debt to GDP at over 125%; (3) no growth potential; (4) Draghi tapered and chose to buy bonds below dep rate and not change the capital key; (5) global yields drift higher; and (6) banking system/NPLs are an ongoing problem. Given this, how can Italian yields be at 2%, and almost 50bps below US?

SG#28: ***Sell 10yr OATs:*** The ECB is exiting and French political risk will loom large.

SG#29: ***Sell 10yr French Bonds:*** Stronger global growth combin4ed with weaker Euro and higher UST yields should place upward pressure on French yields. Q2 election should be negative for French bonds as either it brings anti EU President or pro-growth/anti-regulation President.

SG#30: ***Pay 5y HUF IRS:*** Tight labour market and the Govt are boosting wages further. All this amidst a very loose monetary policy.

SG#31: ***Receive DI Jan20 in Brazil vs Sell 10yr Treasury futures:*** Brazil is starting a sustainable easing cycle while the US is getting out of its easiest policy in history.

SG#32: ***Buy Germany 5yr vs Sell UST 5yr:*** In the US its Trump, inflation, China reserve selling, term premium, FED behind the curve, fiscal stimulus at full employment. In Europe its ECB trying a 'yield curve control', collateral shortage, and likely political safe haven demand.

SG#33: ***Buy JPY 10y10y Straddles:*** Buy at the lows for a ridiculous terminal break-even (-90bps over 10y). This makes money on move/vega if BoJ yield control experiment fails or if it doesn't, and if 10s20s continue to move around.

SG#34: ***Sell 6mth strangle option on EUR 3y2y fwd strikes @ 1%/0% (fwd @ 0.55%):*** 3y2y can't sell off much more now that ECB buying below depo rate.

2) FX

SG#35: ***Buy USD Index:*** Fiscal stimulus and monetary tightening in US should pull up USD. And, outside the US, there are too many fault lines out there.

SG#36: ***Buy USD vs EUR:*** Divergent economic, monetary and political risk environments.

SG#37: ***Buy USD vs CAD:*** Fundamentals are great: positive carry, continuing period of USD shortage, Trump trade war antics. But, it's the recent boost to oil and big drop in USD/CAD that provides the opportunity. The OPEC deal is inherently unsustainable especially as US shale will gladly soak up any excess demand, which is a lose-lose for Canada.

SG#38: ***Buy 6 mth AUD/USD 0.71 Digital with 0.65 RKO in 2mth @ 12.5% offered:*** Cheap AUD downside exposure.

SG#39: ***Buy USD vs JPY, KRW, TWD:*** Real yield differentials continue to widen vs JPY while Asia EM exposed on widening growth expectations and increased political tensions.

SG#40: ***Buy USD vs KRW:*** Monetary policy in S Korea should remain accommodative while US rates are rising. Extended period of political uncertainty in S Korea should stall needed fiscal stimulus while the threat of protectionism leaves the S Korean economy very exposed due to its high dependence on exports.

SG#41: ***Buy USD vs ZAR via 3mth Risky:*** Can buy USD call at 14.25 strike and sell USD strike 13.25 for net premium of 0.2%. Even if global trade fears don't materialize in EM, there are still plenty of idiosyncratic reasons for ZAR to sell off in Q1 2017.

SG#42: ***Sell EUR vs GBP:*** Euro will go from one existential crisis to the next while UK will likely move towards soft Brexit.

SG#43: ***Sell EUR vs AUD:*** Technical consolidation is over and short Euro should perform vs carry currencies. AUD has the advantage from rising Chinese data.

SG#44: ***Sell EUR vs PLN:*** PLN is weak compared to 'value', political risks are falling and economic activity likely to accelerate in 2017.

SG#45: ***Sell EUR vs CZK 1yr Fwd:*** The CNB plans to lift the EUR/CZK 27.00 floor in mid 2017, at a time when inflation pressures are building which means either rate hikes or a bigger than expected move in the cross…..or both.

SG#46: ***Sell EUR vs ZAR:*** Carry plus some signs of hope on politics.

SG#47: ***Buy RUB vs CAD:*** Canadian growth is vulnerable to higher US rates and rising debt servicing costs, so BoC will welcome widening rate divergence with US. RUB has proven resilient to concerns around EM financing and potential for removal of sanctions is a big help. This cross also helps take oil out of the equation. Big carry as well.

SG#48: ***Buy RUB vs USD:*** Likely end of sanctions from both US and Europe (France) at a time of sharply improving cyclical data. OPEC deal a big help for Russian fiscal situation.

SG#49: ***Buy RUB vs KRW:*** OPEC cuts plus better US/Russia relations at a time where China deval prospects continue to simmer and Asia exposed to Trump trade rhetoric.

SG#50: ***Buy INR vs KRW:***

SG#51: ***Buy INR vs AUD:*** RBI on hold and AUD exposed to China slowdown/CNY depreciation while INR solid and great carry.

SG#52: ***Sell CNY:*** Government is trying hard to keep money in the country.

SG#53: ***Sell TRY:*** Meltdown has only just started and firming in the USD will start to affect larger and larger parts of the corporate world (USD/EUR based borrowing).

SG#54: ***Buy CAD vs USD & EUR:*** Rising oil plus an economy that benefits from US acceleration and a currency that should benefit if US implodes and USD goes down.

SG#55: ***Buy GBP vs JPY 3mth Seagull:*** Sell put at 140, buy call at 145 and sell call at 150 at zero cost. Max P&L is 3.6%; cover short at 138 for a stop loss of about 1%. Idea is GBP looks better now as UK inflation rises, growth has been strong, and soft Brexit gives hope. Meanwhile JPY should be weak as risk sentiment improves.

SG#56: ***Buy EUR vs JPY:*** EUR has shorts from the bottom of the range while BoJ is stuck with QE. Populist wave in Europe may have peaked.

SG#57: ***Sell USD vs JPY:*** The long term fundamentals for the USD are sound, but the market has gotten ahead of itself with potential risks around the corner in 2017.

SG#58: ***Buy USD, Commodity Currencies and GBP vs EUR and EM:*** This is a trade where you have exposure to higher US rates, global reflation, yet also have exposure to turbulence in Europe.

3) Equities

SG#59: ***Sell SPX:*** This is the most loved asset and leveraged shorts have been stopped. The asset is priced for a 'good Trump' and none of the 'bad Trumps'. Valuations are back to 2000 bubble levels and even the popular but misguided Reagan analogies would suggest a correction is imminent.

SG#60: ***Sell S&P 500:*** Given negative convexity, I think we will see a repeat of what happened when Reagan took office back in Jan 1981.

SG#61: ***Sell S&P:*** Too much optimism is built in and too little about the trade issues.

SG#62: ***Buy RTY (Russell 2000) 1400/1150 1x2 put spread:*** Reversal of overbought rally in early 2017.

SG#63: ***Sell EEM:*** Waiting for the allocation dust to settle in early Jan, but outlook is for slowing China growth, China tightening, combined with EM negative Trump.

SG#64: ***Sell Emerging Markets Equity Basket:***

SG#65: ***Sell EM Financials:*** Higher rates globally should bite hard when there is a catalyst, and there are plenty of potential ones into 2017.

SG#66: ***Buy US Small Caps vs Sell Tech:*** The former will have their taxes cut while the latter will pay taxes for the first time.

SG#67: ***Buy RIY Index (Russell 1000) vs Sell MTUM US Equity (momentum ETF):*** This relative value trade is premised on another leg of equity market rotation, where momentum strategies are heavily skewed towards tech and should continue to underperform broader market.

SG#68: ***Buy Russia Eqs vs Sell Taiwan Eqs:***

SG#69: ***Buy US Equities:*** Stocks should continue to benefit from tax reform.

SG#70: ***Buy SPX:*** Tax cuts and repatriations will wake up the irrational exuberance monster. I am expecting the biggest inflows into US equities in 10yrs.

4) Combo/Misc Trades

SG#71: ***Buy Gold vs Euro:*** There is potential for instability in Europe at a time when the gold premium in India has collapsed in India due to de-monetization…..we expect China to start buying gold in Q1 for FX conversion and cross-border transfer.

SG#72: ***Buy Gold vs Euro:*** The Trump effect: Fiscal stimulus combined with anti-globalization will generate an inflation debate for the first time in many years, while this will also generate political instability in Europe.

SG#73: ***Buy USD vs JPY & Buy the NKY:***

SG#74: ***Buy BRL NTN-B 2021 & Buy 1yr Fwd USD vs BRL:*** Real rate at 6.20% on the bond and a strong dollar carry due to inverted Brazilian curve.

SG#75: ***Buy Peripheral European Banks vs US 2/30 flattener:*** Great odds on global reflation hedged with US flattener.

SG#76: ***Buy MIB & Sell Euro:*** Hysteria surrounding the Italian Banking system around the referendum has provided an interesting entry level for an outright long (as well as Italy relative opportunity). European growth and inflation will surprise to the upside in 2017.

SG#77: ***Buy 1 unit of HSCEI via futures and sell 2 units of CNH:*** The RMB remains overvalued and strong USD will create a pull; note since US elections China's TWI has appreciated 1%. Inflation helps de-lever and improves earnings in China.

SG#78: ***No Trade:*** Q1 in my mind will be a period with temporary countertrend moves. However, I dislike playing against what I see as a trend, can't play the timing, and thus will wait to re-enter long USD, short bonds, long cyclical vs defensive stocks, and long large cap, DAX, NKY and DJIA.

SG#79: ***Buy RTY (Russell) + XLF (Financials) vs Sell HYG and EMB ETF:***

SG#80: ***Buy 3mth Equity Vol vs Sell 3mth Bond Vol:*** There is significant asymmetry in this trade and merely a reversion to the mean yields a rough 4-1 bet.

5) Commodities

SG#81: ***Buy Oil:*** Saudi commitment to higher prices is meaningful.

SG#82: ***Buy back months of Nat Gas:*** Yes, production will respond to higher prices. But, spreads for next winter/summer are very high with March/April priced at well above what it has averaged in last 20 days to expiry in last 15yrs. That is, March/April is pricing over 50% likelihood of stock outs, while flat price languishes at low levels that show no concern for tight balances. Simply put, spreads imply a raging bullish market while back months (2018) doesn't at all. That makes no sense.

SG#83: ***Buy Grains (Corn and Soybeans but not wheat):*** Large inventories are built into the price, yet next year's harvest is likely to disappoint, so catch up rally is likely in Q1.

SG#84: ***Buy Gold:*** Sentiment is deeply pessimistic and positioning has been liquidated, making gold a neat instrument to play for unwind in bond yields, USD in early 2017.

SG#85: ***Sell Gold:*** We are still decently above year ago levels! Not the best entry point for a short, but positioning is likely still long. QE is out of favor and Trump win makes negative rate talk likely over.

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