Subject: RE: hi jeffrey - a trade to play on global central bank liquidity... [C]
From: Paul Morris <[redacted]>
Date: Thu, 10 Sep 2015 15:56:04 -0400
To: Daniel Sabba <[redacted]>
Cc: Stewart Oldfield <[redacted]>

Classification: Confidential

Daniel, not sure I follow this

Paul Morris

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From: Daniel Sabba
Sent: Thursday, September 10, 2015 3:05 PM
To: 'jeffrey E.'
Cc: Paul Morris; Todd Stevens; Stewart Oldfield; Vahe Stepanian; Ariane Dwyer; 'Richard Kahn'
Subject: hi jeffrey - a trade to play on global central bank liquidity... [C]

Classification: Confidential

Regardless of FOMC hiking next week, we have already observed a decrease in global central bank liquidity. We have noticed this is very correlated to USD 5y swap rates 5y forward and, consequently, to the shape of the yield curve. Given central banks play a major role in overall market liquidity, investors should consider the effects that Fed tightening and China's FX unwind will have on liquidity levels. For the last decade liquidity has been has been positive for real rates and the curve; however, as liquidity decreases this is likely to have negative implications for risk assets. See below and attached.

Fed + FX reserves YoY change and 5y5y rates

{cid:image001.png@01D0EBE1.31985460}

World Equities YoY and central bank reserves

{cid:image002.png@01D0EBE1.31985460}

Investors who wish to articulate a view on a decreasing global central bank liquidity can do so by buying 6 month 5s10s curve floors. The 5s10s is a proxy for the 5y5y, which, as seen above, can be regarded as a proxy to liquidity.

5y5y USD rates and spread between 10 and 5y swaps (5s10s)

{cid:image003.png@01D0EBE1.31985460}

The 5s10s also comes down (curve flattens) during hikes. Therefore this trade could benefit in the event of either a Fed hike, or the event of no hike and a decrease in central bank liquidity

{cid:image004.jpg@01D0EBE1.31985460}

Indicative Transaction Terms:

Investor buys: 5s10s USD CMS curve floors

Expiry: 6 months

Strike: ATMF (56bps)

Notional $100mm

Offer: 10bps (mid 8bps)

Terminal Payout: Notional x max (Strike – terminal 5s10s spread,-0)

Ref. 5s10s Forward: 55 bps

Source for graphs: DB Markets Research US Fixed Income Weekly, September 4 2015 and Bloomberg.

Daniel

Daniel Sabba

Key Client Partners

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