

to a record \$11.415 TN. Reserves have inflated 330% in ten years.

Lets focus on some trades here:

1) This environment is supportive for carry trades, which has been reflected in the outperformance of high yielders following the announcement of the US debt deal.

Long AUD/USD: Longer term investors remain relatively short AUD, which suggests that AUDUSD strength has further to run. A move above parity is unlikely as the RBA should step in. Therefore buy 2m 0.9750 call against selling 2x 0.9900 calls. The AUDUSD risk reversal looks cheap (calls expensive relative to puts). This suggests selling high-strike calls, either outright for those that do not expect further AUD appreciation or to finance a low-strike call for a short-term carry position.

Long KRW NDF : this trade will benefit should CNY appreciation or band widening expectations gain additional traction

Long USD TRY: the market remains relatively short TRY, and with risk premium in USDTRY declining the most among major currencies, these short positions are likely to be at risk from carry traders.

2) HY vs IG compression trade in Europe: Six weeks of retail outflows from high-grade funds but retail inflows into high-yield funds shows that the compression trade in credit is firmly entrenched in Europe. There is a structural reach for yield and this trade still has some legs. I would however hedge out rate risk and stick with spread risk. I will point out that more than \$200bn of "cov-lite" loans have been issued so far this year, more than double the \$100bn sold in 2007. The record issuance means that about 56 per cent of new leveraged loans are now cov-lite !!

3) Long Europe small caps: This is a leveraged trade to a European recovery. European small + mid caps have a higher potential for upside. As European economies improve and small to mid cap valuations in the region continue to look attractive, a re-acceleration of sales and earnings at these companies should drive better performance in European small to mid caps versus the US. Investors looking for yield will find higher levels in Europe versus the US with European small to mid caps yielding near 3% versus approximately 1.4% in the US.

4) Long IT stocks: overall IT spend is expected to grow 0.9% in 2014 compared to ~0.7% growth. Corporate spending sentiment now is on the uptick prompting this move. Also keep an eye on data center growth. Demand for data center services is due to, First, technological evolution -> driving up computing density (servers) and utilization rates (virtualization), therefore data center space must constantly evolve to meet power and cooling needs. Second, increased cost consciousness and core competency focus -> driving greater acceptance of data center outsourcing within Enterprise IT departments.

5) Long Italian Banks / Italian Govvies: another leveraged play on the European periphery recovery. Unicredit clearly stands out. UCG will definitely gain from the European banking union theme. There has been recent talk of this year / early 2014 as a point when impaired loan growth may finally subside and I expect a wide range of cost cutting action. Our strategists think "Italy looks attractive in a twin deficits framework and should benefit from improving fiscal and credit impasse, political risk premium should decline", therefore they recommend buying 10y Italy vs Germany at 230bps, targeting a spread at 200bps

6) Euro Inflation floors: In the euro inflation options market, 5y 0% inflation floor prices are close to their lows. This is not consistent with the 5y inflation swap rates which are by themselves close to lows -> meaning deflation is closer-to-the-money. Inflation volatility has collapsed, probably mostly for purely technical reasons as is all other vol !!. Deflation is not anyone's central case, but a "underpriced tail risk". This creates opportunity for those prepared to pay premium for this risk and therefore would recommend buying the charted 5y 0% zero coupon floors at or around the current level of 20c.

7) KOSPI Calls: The KOSPI2 has been trading within a tight range, realizing only 9.8% over the past 30 days, the lowest globally. Low realized vol has capped short-dated implied vol, driving 1m ATM vol to 12.8%, near all time lows. The Index broke out from a tight range last week and investors should consider buying short-dated calls for upside exposure or replace outright longs with calls. The differential between positioning in EM equities and European equities has reached an extreme - worst on record and 2.4 stdev below