

Subject: Ruble + Morning Commentary [C]
From: Tazia Smith <[REDACTED]>
Date: Fri, 14 Mar 2014 09:46:04 -0400
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Cc: Paul Morris <[REDACTED]>,
Vahe Stepanian <[REDACTED]>

Classification: Confidential

Good Morning Rich -

I wanted to highlight Jim Reid (DB Global Chief Credit Strategist) "Early Morning Reid." It's a good, consolidated daily summary. Some days, it's good, other days it's excellent. Always worth the 5/10min and I thought it would be of interest as it relates to a lot of Jeffrey's positioning. Here in particular you see the highlight of Ruble weakness vs. the dollar to 39.1 (well above Jeffrey's 37.595 binary strike, implying 'in the money' payout). Momentum in the cross continues this morning ahead of Sunday's referendum.

Please see below and attached and let us know how we can be helpful.

Best Regards,
Tazia

"As we head into the poll, we should highlight a research piece from our Russian and Ukraine strategists published last week noting the macro implications for Russia from the increased geopolitical risk. They think that Russia could see a significant rise in capital outflows and the recent ruble weakness will likely intensify inflationary pressures later this year (mitigated to some extent by the CBR's tightening policy). Their analysis suggests capital outflows of US\$100bn could lead to an average RUBUSD rate of 39.1 (vs around 36.5 now)."

(See attached file: Russia - USDRUB Weakness to 39.1.pdf)

----- Forwarded by Tazia Smith/db/dbcom on 03/14/2014 09:35 AM -----

From: "Jim Reid, Deutsche Bank" <[REDACTED]>
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To: Tazia Smith/db/-
dbcom@DBAMERICAS,

Date: 03/14/2014 02:17
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Subject: Early Morning Reid - Macro
Strategy

Deutsche Bank - Fixed Income
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Early Morning Reid - Macro
Strategy
14 March 2014 (2 pages/ 114
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Key Market
Data
(Index @ Close //
Change)
(ITX Crossover @ 280 //
+15)
(ITX Europe 125 @ 78 //

+4)
(CDX 125 @ 68 //
+3)
(CDX HY - pts @ 107.97 //
-0.531)
(S&P 500 @ 1846 //
-1.17%)
(Brent Oil^ @ 107.57 //
-0.44%)
(Gold^ @ 1369 //
+0.11%)
(10 yr Treasury^ @ 2.64 // -8
bp)
^ - Change from previous day's 5:30 GMT to 05:30
GMT

Macro Strategy (J. Reid, A.
Ip)

Outside of the peripheral European markets it's becoming harder to find
a
main equity index that is up YTD now with the S&P500 (-1.17% last night)
one
of the last to fall back into negative territory yesterday. Time is
running
out to turn Q1 round from a risk point of view although we should point
out
that credit is still holding in relatively well. One can understand
the
nervousness at the moment as there are a couple of almost unanalysable
themes
at the moment. Firstly the situation with Russia/Ukraine/Crimea and
secondly
China. Before we try to analyse the unanalysable we just thought we have
a
look at what Q1's normally tell us about the overall direction for the
year
using US data. If we look back at the S&P 500 since 1940, 30 of the 74
years
have seen negative price returns by the end of Q1. Of these 30, 57% of
the
time the market finished the year down overall with an average annual
price
move of -14%. 40% of the time the market recovered by year end to return
an

average of 11% in price terms. Of the 44 times the market was up at the end of Q1, the average price return for the full year was 16%. So there is some evidence that Q1's performance does shape the year to some degree. Could it be a coincidence that we're having these issues in the first full quarter of the taper? Are we more susceptible to bad news now? We think we probably are as liquidity reduces.

Onto the main stories and it's fair to say that there has been increased nervousness ahead of Sunday's referendum in Crimea. The referendum is on whether to break away from the Ukraine and join Russia. In the run-up to the referendum tensions rose yesterday as Russia began military exercises on the border and Ukraine's parliament voted to create a 60,000-strong volunteer force. The upcoming referendum has been dismissed as illegal by Ukraine and the West however Russia continues to support it. European leaders have suggested that any attempt by the Russians to legitimise the result will be met with further consequences, generally believed to imply stronger sanctions. The Crimean parliament has already voted to break away from Ukraine and the referendum is being held with the aim of showing public endorsement of the decision with the referendum itself clearly titled towards Russia with the two options being (1) to join Russia as part of the Russian Federation or (2) for Crimea to become an independent region within Ukraine. The status quo is not on offer. In terms of the campaign leading up to the vote, reports from the BBC suggest that the campaign has been almost entirely pro-Russian with Ukrainian TV channels removed from broadcast in Crimea shortly after the referendum was called. Looking ahead to the result

most

commentators believe that given the Russian political and military control of

the region the result is almost certainly going to be a vote for Crimea to

join Russia. The Crimean parliamentary speaker said on Ukrainian TV that, the

vote was a matter of "legalising opinion" and "there will be no surprises. Do

not even hope." This point is supported by the fact that according to the

last census of the Crimean population (13 years ago), 58% of residents are

Ethnic Russian whilst the number of Ukrainians is estimated at 24%.

The

Crimean parliament has formally invited OSCE election monitors, but the OSCE

does not plan to send anyone because of its stance that the vote is

"illegal". Indeed Reuters reported that observers from the OSCE have already

been blocked from entering Crimea when shots were fired by pro-Russian troops

on March 8th (Reuters). Meanwhile, Russia plans to send 24 MPs to observe the

referendum and eight election officials to oversee the vote (BBC). The result

of the referendum is expected to be announced no later than 10 days after the

vote. As we head into the poll, we should highlight a research piece from our

Russian and Ukraine strategists published last week noting the macro

implications for Russia from the increased geopolitical risk. They think that

Russia could see a significant rise in capital outflows and the recent ruble

weakness will likely intensify inflationary pressures later this year

(mitigated to some extent by the CBR's tightening policy). Their analysis

suggests capital outflows of US\$100bn could lead to an average RUBUSD rate of

39.1 (vs around 36.5 now).

Turning to Asia, the news flow from China has been fairly mixed overnight but

the price action is more unambiguous with falls in the Shanghai Copper futures (-0.9%), HSCEI (-0.9%) and Hang Seng (-1.3%). The latter has been weighed by a sharp fall in Tencent (-5.1%) one of the world's largest internet companies, on reports that the PBoC has called for a halt to virtual credit cards operated by the company. China worries have also sent Australian mining stocks down 2.3% and the Nikkei is down 3.4% with all industry sectors suffering >2% falls. S&P500 futures (+0.1%) are slightly firmer though and US treasury yields are trading flat in Asian trading following yesterday's 9bp move lower. In domestic Chinese equities, banks are leading the markets losses as concerns over corporate defaults continue to weigh on the sector. On the topic of potential defaults, Chinese equipment-maker Boading Tianwei, who generated headlines earlier this week as a potential second default in China's domestic bond sector, released a statement saying that it will be meeting its coupon payment obligations on July 11th this year. The bonds are guaranteed by the company's central-government-linked shareholder. The bonds remain suspended from trading though. There was also news that trust products linked to Shanghai Chaori (the first domestic corporate bond issuer to default last week) have been "paid off" by Zhongrong International Trust Co, suggesting that maybe the trust product's investors may have been able to recover a substantial amount of their investment (Shanghai Securities News).

On the topic of China, our commodities research team writes that fears of Chinese commodity finance deals could unravel and result in widespread metals liquidation might be overdone. In their view, the recent sell-off in copper prices has been primarily driven by speculators trying to anticipate

the
unwinding of financing deals, rather than actual widespread unwinding
itself.
According to their channel checks, the scale of actual unwinding has
been
limited so far. For more detail, a link to their report can be accessed
here:
[https://ger.gm.cib.intranet.db.com/ger/document/pdf/-
0900b8c0880451cb.pdf](https://ger.gm.cib.intranet.db.com/ger/document/pdf/-0900b8c0880451cb.pdf).
Elsewhere in Asia, there was little reaction to the latest BoJ minutes
where
members said that the economy and prices were on track with Bank
forecasts.

Away from the worries in EM, there were interesting comments from Draghi
in
his prepared remarks at a presentation ceremony in Vienna yesterday.
Draghi
said that the ECB's efforts in repairing bank balance sheets prior to
the
start of the Single Supervisory Mechanism was in a sense
"encouraging
creative destruction in the banking sector". He said he wanted to
avoid
"zombie banks" that do not lend and that interfere with the "churn
process
between firms entering and exiting the market that is a crucial driver
of
productivity". We wouldn't disagree with these comments. As we have
argued
many times in the past, low default rates are a big feature of this
high
liquidity world which is great if you're a credit investor but its
highly
debatable whether it's good for the wider economy in so much as it
distorts
the efficient allocation of capital. Defaults are a good thing through
time.
However with so much debt outstanding now we may have long passed the
point
where you can allow defaults without causing major systemic concerns
and
subsequent economic weakness. On a separate matter, but also related to
the
banking industry, the FT wrote yesterday that Barclays is planning a
"radical
overhaul" of its investment bank with a new management strategy to
be

unveiled before the
summer.

Looking at the day ahead, it's likely that the focus will remain squarely on geopolitical developments rather than economic data. All eyes are on the Kerry-Lavrov meeting in London today, but it's fair to say that expectations of this meeting are low at this point. The world will be watching the Crimean referendum on Sunday, but as we mentioned above, the outcome of the vote seems pretty certain at this point and it will be more about how the protagonists react to the formality. The main data releases are US producer prices and the UofMichigan consumer confidence report.

Other Market

Data

(ITX Sen Fin @ 95 //
+6)
(ITX Sub Fin @ 141 //
+6)
(CDX EM @ 328 //
+5)
(ITX Japan @ 81 //
+2)
(ITX Australia @ 107 //
+4)
(ITX Asia XJ @ 133 //
+2)
(Euro NonSov @ 82.74 //
+1)
(Euro Corp @ 117 //
+1)
(Euro BBB @ 154.09 //

+1)
(Sterling NonGilt @ 125 //
+1)
(Sterling Corp @ 152 //
+1)
(Sterling BBB @ 199 //
+1)
(WTI Oil^ @ 98.19 //
+0.34%)
(Dollar Index^ @ 79.66 //
+0.06%)
(EUR/USD^ @ 1.386 //
-0.32%)
(DJ Stoxx 600 @ 325 //
-1.05%)
(NIKKEI @ 14318 //
-3.36%)
(Hang Seng @ 21484 //
-1.25%)
(VIX @ 16.22 //
+1.75)

Key Economic

Data

(Release // DB // Prev //

Con)

(Producer price index (Feb) // +0.2% // +0.2% //
+0.2%)

(Ex food & energy // +0.2% // +0.2% //

+0.1%)

(Consumer sentiment (Mar pre.) // 80.0 // 81.6 //
82.0)

Topical Deutsche Bank

Publications

* Focus Europe - Euro Futurism, 28 Feb
2014,

[http://pull.db-gmresearch.com/p/2983-86F5/71648899/-
DB_FocusEurope_2014-02-28_](http://pull.db-gmresearch.com/p/2983-86F5/71648899/-DB_FocusEurope_2014-02-28_)

0900b8c087fc239c.pdf

* Data Flash - ECB: Stuck, 6 Mar

2014,

http://pull.db-gmresearch.com/p/2852-8B34/84723838/-DB_DataFlash_2014-03-06_09

00b8c08801cb83.pdf

* European Equity Strategy - Global credit impulse - the already substantial

EM adjustment, 7 Mar

2014,

<http://pull.db-gmresearch.com/p/-4703-7FF9/85443988/0900b8c087f868af.pdf>

* Asset Allocation - Breakout Should Sustain, 6 Mar

2014,

<http://pull.db-gmresearch.com/p/-1350-9767/84959161/0900b8c087ffdbd5.pdf>

* Global Economic Perspectives - Asia's export engine revs up, 28 Feb

2014,

http://pull.db-gmresearch.com/p/1755-1B73/70852402/-DB_GEP_2014-02-28_0900b8c0

87f7322a.pdf

* China Special Report - China: growth and reform targets for 2014, 6 Mar

2014, <http://pull.db-gmresearch.com/p/2207-8BAE/-81060578/0900b8c088006d7d.pdf>

* Special Report - Ukraine & Global Commodities, 3 Mar

2014,

http://pull.db-gmresearch.com/p/5-269F/76422456/-DB_SpecialReport_2014-03-03_0

900b8c087fe8cd4.pdf

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