From: "Ens, Amanda" <[redacted]>
To: "Jeffrey Epstein"<jeevacation@gmail.com>
Subject: MEGA AM: Risk Parity Scenario Tool
Date: Tue, 09 Aug 2016 15:11:37 +0000
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cid:38917479

Summary:

- We expect US nonfarm productivity to increase 0.6% qoq saar, up from -0.6% in 1Q.
- Japan: After a decent JGB auction, if yields decline further in the super long sector, domestic investors seeking positive yields could lose the last destination for their demand.
- Global Equity Volatility Insights: Last week's sharp sell-off in JGBs renewed concerns of forced selling by risk parity funds. We provide a simple scenario tool.
- UK: GBP traded below 1.3000, after comments from the BoE's Ian McCafferty and J-Curve worsens trade balance.
- Situation Room: We find that the BOE and ECB corporate bond QE programs are creating a lot of attractive relative value in the dollar market as Spanish 10y Bond Yields fall below 1% for the first time.
- In Gold we are still seeing further interest by investors to buy year-end upside.
- China: July CPI inflation eased to 1.8% yoy from 1.9% in Jun on lower food inflation.
- The Reserve Bank of India held the repo rate unchanged in today's policy meeting citing continued upside risks to the 5% inflation target to be achieved by March 2017.

We expect US nonfarm productivity to increase 0.6% qoq saar, up from -0.6% in 1Q. However, it would still result in the year-over-year rate slowing to 0.1% from 0.7% in 1Q. With productivity improving, unit labor costs likely slowed to a 2.1% pace from 4.5% in 1Q. This translates to a 3.1% year-over-year pace versus 3.0% in 1Q.

Japan: If yields decline further in the super long sector, domestic investors seeking positive yields could lose the last destination for their demand. Excessive easing by the central bank could end up depriving the market of lower risk assets and raising systemic risk.

Japan: All eyes were on the 30Y JGB Auction and rates are stable post the results. The bid-to-cover ratio in the 30y JGB auction was of 3.07 and stronger than prior 2.64. However, we are seeing very limited flows post auction results and no follow-through buying interests for now. **While 10y JGB yields fell after the auction, the 40y did not**. In equities, TPX is down 1% MTD but crowded defensive sectors are down 6% MTD and unloved high beta sectors are up 3%.
cid:1852284626

Global Equity Volatility Insights: Last week's sharp sell-off in JGBs renewed concerns of forced selling by risk parity funds. While the draw downs in US Treasuries, US equities, and ultimately risk parity portfolios were small (i) leverage is still near max levels across a variety of risk parity parameterizations, (ii) bond allocations are historically elevated, and (iii) markets continue to be skeptical of a 2016 Fed hike. Hence we provide a simple scenario tool. For example, a -2% daily decline in the S&P 500 coupled with a -0.6% fall in 10y Treasury prices (poor diversification) could trigger a 25% deleveraging (of unlevered notional) today, whereas a -4% SPX drop and +1% bond rally (good diversification) would generate no selling pressure, underscoring the critical role played by bond-equity correlation in governing the severity of risk parity unwinds.

cid:1981083237

UK: GBP traded below 1.3000, after comments from the BoE's Ian McCafferty. In an op-ed in The Times, he noted that if the UK economy proves to have turned down in line with initial survey signals, he believes more easing would likely be required. At the same time he acknowledges that rates can be cut closer to zero and QE could be stepped up. The article goes on to say that the BoE should follow a gradual approach in how it responds to Brexit given information on the exact reaction is still very limited. While McCafferty was in favour of last week's rate cut, he was one of three officials to vote against more QE.

UK: J-Curve worsens the trade balance
cid:709226104

Situation Room: We find that the BOE and ECB corporate bond QE programs are creating a lot of attractive relative value in the dollar market.

Spanish 10y Bond Yields fall below 1% for the first time.
cid:1152287995

In Gold we are still seeing further interest by investors to buy year-end upsides, so sentiment still remains bullish but perhaps the timing for higher prices is now being put towards the back of the year, coinciding with the US presidential election.

AUSTRALIAN JULY BUSINESS CONDITIONS FALLS TO 8
AUSTRALIAN JULY BUSINESS CONFIDENCE FALLS TO 4
A sharp drop in conditions but still above the 5 average. More in line with our expectation for a slower profile of growth to justify the rate cut last week.

China: July CPI inflation eased to 1.8% yoy from 1.9% in Jun on lower food inflation. PPI deflation narrowed to -1.7% yoy from -2.6%. Despite the recent softening trend in headline CPI inflation, t is still too early to worry about outright CPI deflation. We expect no further interest rate cuts in the rest of 2016 and 2017.

The Reserve Bank of India held the repo rate unchanged in today's policy meeting citing continued upside risks to the 5% inflation target to be achieved by March 2017. The knee-jerk sell-off in the NDOIS market suggests that there may have been some hope for a rate cut. The market continues to price in a cut in the October policy meeting. On FX, we are unwinding our long USD/INR risk reversals. We believe there is limited upside in keeping a long USD/INR position.

Greg Kaldor
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