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Vinit is working with me on some large clients now, good resource, I will introduce you to him and few other sr. folks before year end either in NYC or in europe, just some directional thoughts/observations not necessarily for you,

▼ Vinit Sahni

----- Original Message -----

From: Vinit Sahni
Sent: 10/20/2013 07:05 PM GDT
To: Vinit Sahni
Subject: Weekend Snippets (internal only) [I]

Classification: For internal use only

Here we are -> record highs for the S&P 500, the S&P 400 Midcaps, and small cap Russell 2000. Should we be asking ourselves if this is the Terminal Phase or will this continue ?

In these snippets here is a quick mark to market on where we are and some of the trades below. The theme of the trades below is very clear, carry outperformance and lower vol. Vol has broken down and we are on the leg down to 2009 levels (includes FX vol, rates vol, commodity vol etc) -> this has prompted additional risk taking and technicians for example are calling for 1775 levels in the S&P -> sharpe ratios of high carry trades looks very compelling here

Mark to Market:

With the US government reopened / debt ceiling raised, Obama stated -> there were "no winners." It's been only about 3 weeks, but the fourth quarter has already shown itself worthy of the history books. If the spec community can hold gains through year-end (the vol markets are alluding to) -> the ranks of billionaires will surely inflate further. No winners, right ?

This week saw the S&P500, the S&P 400 Mid-Cap Index and the small cap Russell 2000 all trade to record highs. The week's 2.8% advance increased the small caps' year-to-date gain to 31.3%. Google added about 140 points and \$38.5bn of market cap this week (to \$338bn) to reach an all-time high (up 43% y-t-d). The more speculative "beta" stocks continue to outperform. The NASDAQ 100 (up 3.7% this week), Morgan Stanley High Tech Index (up 2.6%) and The Interactive Week Internet Index (3.4%) all traded to the highest levels since 2000. Treasury, MBS, and corporate debt prices were higher as well. It all adds up.

The QE-enhanced 2013 version of "how crazy do things get?" is outshining even the 1999 speculative melee, yeah!! The (post-LTCM bailout) year 1999 saw the small cap Russell 2000 Index jump from 422 to 505 (19.7%). This year, it has already run from 849 to 1,114 (up 31.3%). The S&P400 Midcap Index jumped from 392 to 445 in 1999 (13.5%). With more than two months to go, so far it's 1,020 to 1,290 for the midcaps (up 26.5%).

Why stop just at the US. Germany's DAX equities index added 1.6% this week to a new all-time high (up 16.5% y-t-d). Italian stocks jumped 2.1% (up 18.4% y-t-d) and Spanish stocks surged 3.5% (up 22.5%), both to more than two-year highs. Australian stocks gained 1.7% (up 14.5% y-t-d). Despite major economic issues, India's stock market jumped 1.7% this week to within a couple percent of new highs. Stocks jumped 4.2% in Brazil and 4.3% in Argentina. Indonesian stocks rallied 4.5%. Around the globe, most equities markets pushed higher. Fueled by huge ETF flows, total equity mutual fund inflows this past week jumped to a whopping \$12.7bn.

You may want to see this -> On a weekly basis, global central bank International Reserve Assets (data from Bloomberg). This data provide a decent proxy for global financial flows, especially to the emerging markets (EM). From \$6.63 TN back in April of 2009, International Reserves surged this week 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 its 10-year average. Even the NKY 3M ATM vol dropped to an 8-month low !!!

8) UK Banks: On the back of weak FICC earnings across the street, Barclays I feel has hit Rock Bottom. This reflects the sentiment around FICC geared investment banks generally, but also the horrible six months that management has seen. My personal view is that rates + credit will recover in 2014 as tapering will create a steeper curve and volatility. I also think Barclays leverage ratios will improve soon and Barclays will push through an aggressive cost cutting plan.

Quick Macro Snippet:

What should we be focused on: The most important market drivers will now be the 1) US labor market data and 2) Eurozone inflation. An improvement in the former will determine the timing and pace of Fed tapering. A decline in the latter will determine whether the ECB will stay on hold, or loosen policies. The Sep NFP is on Tuesday stay focused.

Gold some technicals - couldn't resist: The bears are still fighting the recent up move, here are some technicals to rebase...

The volatility in gold over the past several days has been impressive. A close above 1330 (Oct-08 high) would be the first sign of basing and a turn higher, while bulls gain control only AFTER a close above 1375 (Sep-19 high). A close below 1270 exposes the Jun-13, bear trend lows of 1180

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