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Good morning John,

Overnight Risk-Adjusted Return Monitor

Cross-Asset	Foreign Exchange	Fixed Income	Equities	Commodities
UST 5-yrs	USD/JPY	UST 5-yrs	China SHCOMP	Corn
USD/INR	USD/INR	UST 30-yrs	Thai SET50	Gold

*This monitor highlights the largest positive and negative risk-adjusted returns overnight on a cross-asset and single-asset basis, including ~60 investment expressions globally. It is designed to hypothesize where the greatest PnL sensitivity exists and whether outlier price moves are impacting sentiment.
**1d RiskAdj = 10x (Percent Change on Day / 30-Day Realized Volatility)

Overnight Summary & View

**This is a sample of various sections taken from different days to illustrate the breadth of information provided.*

Rarely does US Fixed Income lead broader market sentiment overnight but for the first time in multiple years, the front-end of the US Treasury curve is being challenged (i.e. selling). To what degree this will continue is yet to be determined but the reasons as to why front-end yields are becoming less anchored are powerful and the majority of investors have not observed this important shift.

Reason 1: The shift to Forward Guidance from Quantitative Easing by the Federal Reserve and Bank of England is not being received well by investors.

If the measurement is a clear communication strategy, QE explicitly illustrated the size, composition, and schedule of bond purchases. Conversely, Forward Guidance is based on economic projections that come from an institution (i.e. Fed) that has an extremely poor track record of forecasting growth, employment and inflation. With respect to the BoE, the addition of “knockouts” in their Forward Guidance either lowered the credibility of the new Governor or highlighted the lack of broader government support for unconventional measures.

Add in the debate and uncertainty around the next Fed Chairperson and it is easier to understand there is anything but clarity at the moment.

Reason 2: The traditional benchmarks that argue for the front-end of Treasury curve to move higher in yield are close to historical precedents.

- 2s10s Yield Curve historically peaks at ~275bps (high ~280) before the first Fed hike (vs. last ~253 bps).
- This indicates 10-yr yields can back-up to ~3% before 2-yr yields become unanchored (vs. last ~2.93%).
- Historically, 2-yr yields trade ~50-100bps above the Fed Funds rate until the Fed shifts policy in favor of a rate hike.
- This indicates 2-yr yields can back-up to 100-125bps (vs. last ~40 bps).

Reason 3: Foreign and Domestic selling pressure.

Emerging market countries that are defending their currency are likely sellers of UST 2 and 5 year paper as the majority of their holdings are in intermediate-term duration. The Central Bank selling pressure is now being observed at the trading desk level and in data that attempts to capture reserve manager money flow.

With consensus expectations for the first interest rate hike in 2H 2015 and based on the historical framework laid out in Reason 2 above, Fixed Income investors recognize that 10-yr yields could back-up to ~4% by end of 1H 2015. Relative to recent yield levels of 2.75-2.93% that is over 1% way and for every 100 bps move that equates to a 5% principal loss (net of coupon payments). The point being is that Retail investors are earnings 40-160 bps on their 2-5 year Treasuries and recognize the asymmetrical loss potential in their “cash” holdings and are selling.

Top Overnight Observations

1. See chart of long US Financials (XLF) vs. short Energy (XLE). The bottom of the 1.5 year channel coincides with the 100-DMAVG, both have decisively broken highlighting a key rotation signal between US Equity sectors. With consensus continuing to build that Housing has either paused or rolled over, Financials are starting to demonstrate a weakening pattern. The second chart physically illustrates the relative rotation on a weekly basis over 12-weeks. The x-axis in the graph represents the relative strength and the y-axis measures the momentum in that relative strength. As you can see, Financials are moving from a “leading” to “weakening” quadrant and Energy has already moved from a “lagging” to “improving” quadrant.

   **The model portfolio remains short XLF vs. long XLE with the above adding more credibility to the thesis.*

2. Indian Rupee posted the largest negative risk adjusted return overnight across regions and assets. Again, this highlights that professionals are not short EM FX and continue to add short positions as Brent Crude Oil appreciates. Similar weakness was seen in Turkish Lira, Malaysia Ringgit, Philippines Peso, Indonesian Rupiah, and Thailand SET50 Equity Index (i.e. Asian stronghold) highlighting the spreading of contagion.

3. The grains – Corn, Wheat, Soybeans – are receiving a fair amount of focus due to short-term weather conditions (i.e. dry weather into Labor Day) and are starting to exhibit the positive August seasonality patterns that were widely observed at the beginning of August but little buying action was taken.

4. Chinese Equities (SHCOMP) was the best performing Equity index overnight. Speculation around 2H stimulus and looser financing initiatives continue to mount as does economic stability rhetoric from officials but what is most interesting is that Credit Suisse today followed Deutsche Bank from last week in increasing 2H 2013 GDP estimates.

    - This will again inspire the Gold Miner trade, especially with Gold Futures breaking 1400 and the charts supportive from a technical standpoint.

    - Add in the weekend Barron's call on coal name, Peabody Energy (Symbol: BTU), which derives a significant portion of revenues from Australia (i.e. China link), and there is greater sympathy for the Material sector as a whole to outperform today.

Rareview Macro Model Portfolio - Updates

Trade Idea - The 67 Straddle That No One Has

This has not been observed on the Street, period. The Nasdaq in January 2013 has only had a net change of the highest close to the lowest close of ~164 bps, this is the smallest monthly closing range in the history of the NDX. In 2013, ex January 23rd (Google earnings), the NDX has closed within the first day's trading range every day.

See below analog and chart, there have been only three other times of less than 3% ranges - December 2004, April 2006 and May 2007.

Fully mindful that the limited sample size is not statistically relevant but one still has to acknowledge this outcome due to the record tight close and because this index was able to record this closing range given the outsized volatility in leadership names or rotation.

Every major contributor with respect to index weight of the NDX has reported quarterly earnings. Hence, single stock volatility has removed earnings events and is now less expensive to express a view.

The QQQ 67 straddle to March 1st costs 2.00 which is 3% of spot. At time of sending, the last price is 67.00.

The narrative and sentiment is clearly towards major indexes eclipsing their respective all-time highs, Russell already has, and Dow and S&P are widely expected to follow. If one was to believe the S&P was going to see 1577, the NDX would significantly outperform based on this lack of volatility or follow through in risk assets.

The counter would be the historical pattern highlighted above, that being down ~800 bps intra-month. Harvesting alpha or mitigating risk, either argument, the NDX is a very strong hedge for February 2013. This will never mitigate Yen risk but Dollar Yen is not at 100 and US bonds are not 143 if the Nasdaq were to fall 800 bps.

One unit of the QQQ Mar 1st 67 straddle for ~2.00 has been added to the model portfolio.

Closing range of Nasdaq for the month is less than 3%
3 Occurences

Date	Day	HighNextMonth	LowNextMonth
1/3/2005	Mon	-0.522	-8.8732
5/1/2006	Mon	0.9936	-8.9129
6/1/2007	Fri	0.8151	-2.7817
	Avg	0.4289	-6.8559
	AvgPos	0.9043	NaN
	AvgNeg	-0.522	-6.8559
	PctPos	66.6667	0
	PctNeg	33.3333	100
	Maximum	0.9936	-2.7817
	Minimum	-0.522	-8.9129
	StdDev	0.8283	3.5284
	ZStat	0.5178	-1.9431
	Variance	0.6861	12.4498

Source: Bloomberg

Central Bank Previews

European Central Bank (ECB) - announcement 12:45 BST/ Press conference 13:30 BST

1. Analysts are unanimous in expecting the ECB to leave all 3 rates unchanged: Marginal Lending Rate at 1.50%, Refi Rate at 0.75% and Deposit Rate at 0.00%.

   - Barc: expect the ECB to leave rates unchanged, but expect a refi cut in Q1.
   - BNP: expect the ECB to leave rates unchanged with no further cuts expected.
   - BoA: expect rates to be left unchanged.
   - Citi: expect the ECB to leave rates unchanged, with a possible 25bp rate cut in February or March.
   - Commerz: expect the ECB to leave rates unchanged.
   - Credit Agricole: expect ECB to leave rates unchanged, but expect the Refi rate to be cut to 0.50% in Mar.
   - CS: expect the ECB to leave rates unchanged.
   - DB: expect the ECB to leave rates unchanged with a 25bp rate cut in March.
   - GS: no rate cuts for the foreseeable future and don't expect any additional non-standard measures.
   - HSBC: expect the ECB to leave rates unchanged.
   - JPM: expect the ECB to leave rates unchanged. Expectations for any change at future meetings low.
   - MS: expect the ECB to cut the Refi rate rate by 25bp but not the Depo, with the risk that the ECB delays. It sees a total of two possible 25bp cuts, with the ECB then on hold until at least the end of 2014.
   - Rabo: expect the ECB to leave rates unchanged with potential for 1 further 25bp cut in the future.
   - RBS: expect the ECB to leave rates unchanged. Expect rates to be on hold for the rest of the year.
   - SG: expect the ECB to leave rates unchanged. A rate cut alone is insufficient.

Bank of England - Announcement at 12.00 GMT / No Press Conference

1. Bloomberg survey of 39 economists/strategists voted unanimous that bank rate will remain on hold at 0.5% with 29 opting for no increase of QE, 8 opting for a £25B increase and 1 each for £50B and £75B respectively.
2. Recent Reuter's poll of economists has seen the probability of a QE expansion at this meeting increase from around 20% a month ago, to 40% as of last week and 60% for more QE this year.
3. Latest Citi poll (103 votes at time of writing) seen 39% think no further QE, 46.5% see GBP25B and 14.5% see GBP50B.

- RBS: MPC to leave policy settings on hold. Probability of further QE or rate cut at some pt this yr ~40%
- BNP: £25B extension in purchases. Expect GBP 100bn extra QE coming from Aug & more credit easing
- CRT: No change - close call, but overnight PMI Services improvement arguably buys some times
- Citi: MPC will keep monetary policy loose and loosen further. Expect QE target to GBP450bn year ahead
- JPM: Forecast shows QE and Bank Rate unchanged. Chance of policy action from the MPC has risen
- MS: No Bank Rate cut until Carney becomes Governor. Fiscal growth not disappointing enough for QE this month Goldman Sachs: Further credit easing measures (like FLS), possibly supplemented with further Gilt purchases
- Scotia: Expansion of QE at this week's meeting is more likely than not
- Santander: No change to policy, appears little reason to oppose front-end pricing
- HSBC: Close call, but believe a majority will opt to keep policy unchanged
- Barclays: Unchanged but April MPC meeting may well become a focal point for market expectations
- BAML: Rates on hold and QE unchanged at 375bn, but risk of 25bn increase in QE

*Sources: ITC, MNI, REUTERS, RVM

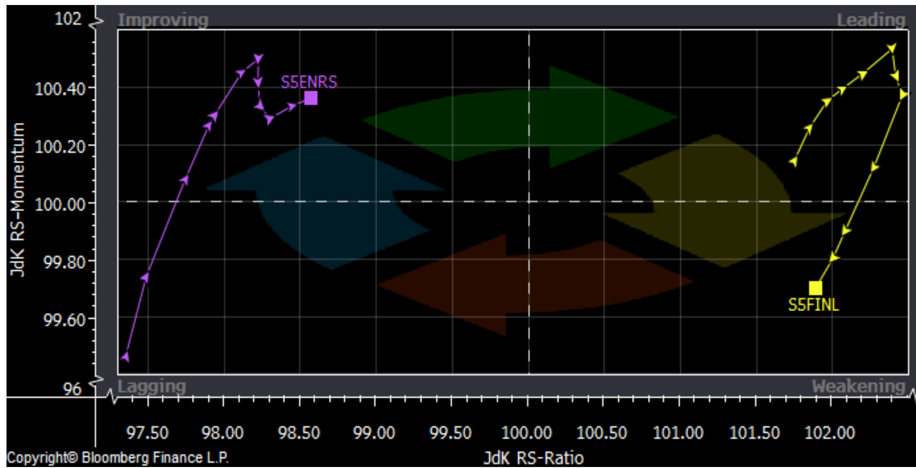
US Yield Curve – Front-end Yields Rising

Source: Bloomberg

Ratio Chart: Long US Financials (S5FINL) vs. Short Energy (S5ENRS) Unwinding

Source: Bloomberg

Relative Rotation Graph (RRG) – Financials (S5FINL) vs. Energy (S5ENRS)



Source: Bloomberg RRG Function

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