May 29, 2018

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Macro
Strategies

State of the Markets: Trade Commentary

Updates On My Recommended Trades

1. **I am changing the strike and maturity date of my 1.21 EUR put/ USD call position**
2. **I am closing out my outright long regional banks**
3. **I am closing my long Europe banks position**
4. **Continue to short EM. I will be out in the next few days with more shorts recommendations**

Restriking My Euro put/ USD call (5/29, TRO + 526%)

Although I did recommend this trade before the recent euro sell-off, I wish I could say this view was based on the reemergence of existential risk for the EMU, but I didn't. My view was based on two factors: trump tax reform, and over optimist expectations of European growth. Tax cuts would give the Fed more ammunition to continue with their path of rate hike if not accelerate them. Corporate reform could strengthen the dollar by spurring investments from the rest of the world into the US. I thought the European curve was way too optimistic that the ECB would start their unwind of QE and low rates given the surprise strength in European growth. I thought that European growth could not sustain 2017 levels and would slow, reducing the likelihood of ECB action and weaken the euro. I still believe in that view, and maybe some of the depreciation of the Euro can be explained by the market pricing in the weakening growth of the last few months. I did think that this cycle would have further downside from the outcome of the Italian election, which I thought was just another round of noise. If I had added the "Italian Issue" into my theme, I would have taken off long European bank trade at the beginning of April. So, I won more than I lost for sure even with the 100% loss on that trade after hitting stops. Having said that I believe the adding the reemergence of the existential crisis of the EMU makes the trade even more compelling now. Growth will continue to slow in Europe as projected but even more so given the uncertainly around Italy. Accordingly, I am moving my 1.21 strike down to 1.13 strike, basically moving my delta roughly back down to roughly 30%. I am also changing the maturity to Dec, thinking that I don't need the wait for things to happen.

Other possible variant of this trade is the short of the European yield curve or being long European long rates and short us long rates. I think the Euro put convers these as well but I open to the discussion. A risk of staying in the trade is that positive news could still change the trajectory of the Euro given how far it has moved. For example, at some stage in the next few months the troika could give Greece a lifeline and extend out their debt given their reforms.

Closing My Regional Bank Trade (5/25, TRO 382%)

I am still positive on the regional banks, but it is more of a single name trade at this stage and there is not yet a specific event on the horizon that will create an asymmetric upside for the entire sector. I gave it a few days after the signing of the S2155, to see if I got more out of the trade, but clearly "buy the rumor, sell the news "was in effect. I still believe the passage of Dodd-Frank reform is a game changer for this sector. I expect price-tangle book to grow from at least three factors: earnings, leverage and consolidation. They will be increase earnings because they will be able to originate and hold higher yield but risker assets. They will relevaage from historically low levels either by growing their balance sheets, or more likely by returning capital. Finally, I see multiple expansion as M/A gets unleashed in the sector both because of the first two factors but also as the higher capital from higher assets is now removed. Having said that, these events will be sporadic and difficult to position for at the index level. Selection at the individual bank level is a compelling but it does not fit my framework. If you are interested, I have done quite a bit of work at that level in my research form the broader index trade.

Closing My Long European Bank Trade (5/24, TRO -100%)

I closed this trade after the market sell-off at the end of the day on Thursday as the position hit my stop. In my defense I would like to say that this was a difficult trade to excute in my non-single name framework. And, of course, I was clearly wrong about Italy. My view was very much a repricing of southern European banks given economic growth and the turning of the NPL cycle in their favor. Really just an extension of successful long Greek bank and GGB trades. However, I recommend European bank index trade that covered all areas of Europe given there was no southern European banks index. But, in the end it did not mater. The performance of northern European banks looks similar to southern European banks, both bad. After closing this trade, at this stage, I will likely go back to my long Greek bank story, but I need to reexamine this before I recommend it again. As I talked about above, an extension of the debt held by the Troika could be an event that would reprice this sector.

More EM Shorts

I will add more ideas later but for now continue to short EM equities and commodity EM currencies, even after the sell-off, there is much more left.