Trades & Fades

European Credits: How they trade vs what they are...

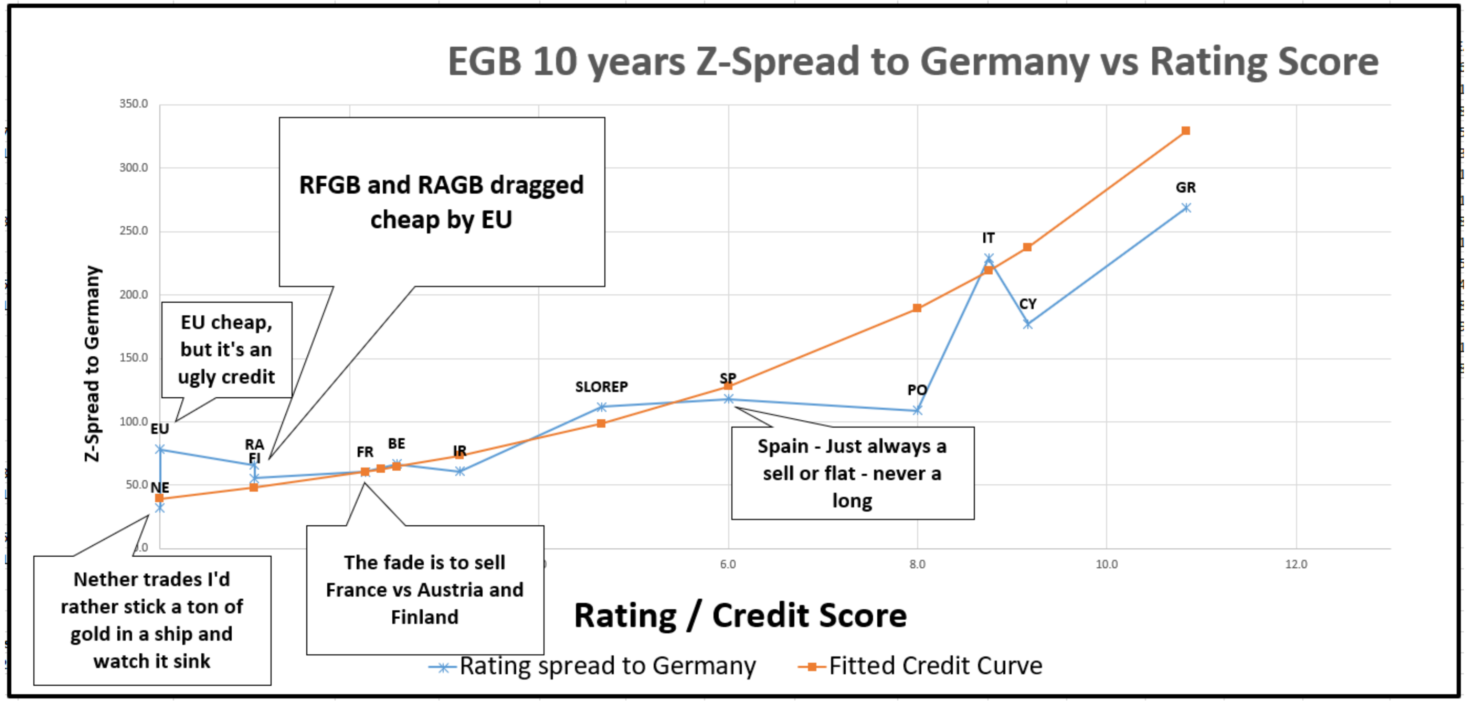
"They don't think it be like it is, but it do"
-Oscar Gamble

James Rice, Astor Ridge

Sep 5th

Trading Strategies & Modelling

EU supply weighs heavy on Nether, Finland and Austria



Graph: EGB 10yrs Z-Spread to Germany vs ‘Credit Score’

*credit score is a proprietary credit metric using rating from the top 3 agencies plus the credit outlook

On my Radar

- **Eurex Rolls** – weak longs are out by month end, temporary scramble for U2 basis vs front months, collateral month end fears, indeterminacy of back month CTD. All means Z2 contracts could cheapen further
- **Supply** – light week, Austria supply – the name has cheapened and cheapened but now look interesting in true value
- **Credit** - EU supply has crushed Ragb and Finland – they look cheap to me. The smart fade is to sell France vs those names. We have Long Nether coming up soon – not a buyer, perma rich always wanna be short to flat
- **Curves** – Curves has a decent vol here. To be honest, I thought that various parts of the curve were not that correlated. Looking at Germany 1y1y vs 5y5y the the curve is very flat – in my mind if we accept were inflation and therefore short rates expectations are, we could be in for a bear steepening in EGBs
- **Forward Swap Spreads** -

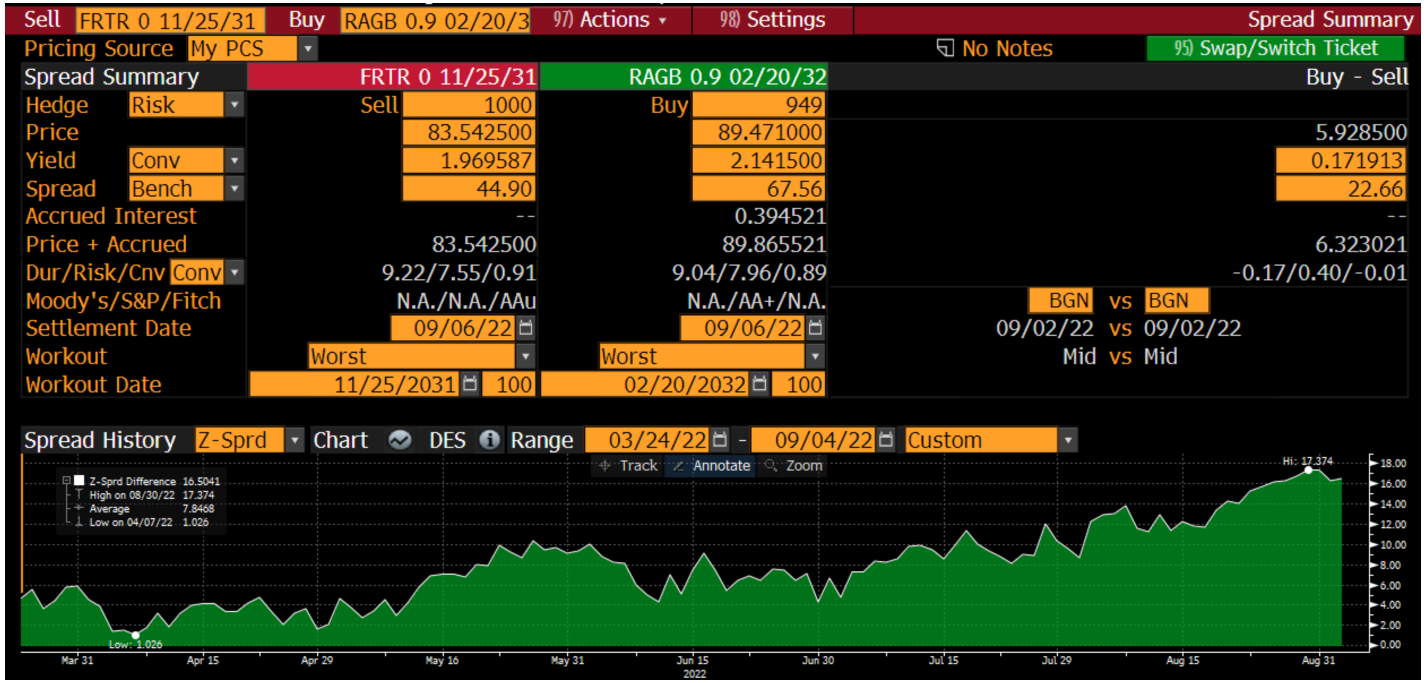
Eurex Rolls go bid, front basis to go offered

- It can be the case that any loose longs like to have rolled prior to the delivery month. Even though Eurex contracts do not have an wide 1 month delivery window.
- My sense is that front month contracts, where the net basis hasn't converged to zero until towards the very end of the contract cycle, have a good chance of staying bid right into expiry
- With collateral concerns over quarter yr end, the persistent bid for many bonds as 'Special' and the ongoing indeterminacy of CTD into December for several contracts means that we could get a repeat of last June – where after the roll Basis is irrepressibly bid (~ Z2 contracts get even cheaper)
- To that end – I think there's a strong asymmetry in Net basis vs the front month – worst case you get delivered with tiny neg carry…
- The upside has a huge fat tail distribution of outcomes – where the trading book mutation are many; –rolling with the strength to sell front months without having to box bonds, seeing front months continue to perform, buying other off the run specials back vs front months at a discount
- As we talked about last June – the propensity, capacity and valuation means to absorb long Z2 contracts vs Z2 CTDs seems diminished since June. I just don't like being long Z2 vs anything. Structurally I will be trading cash vs cash

Supply: Austria 10y is fundamentally cheap vs France

- We are all guilty of it – looking at a chart of history and thinking that tells us something of 'value'. It tells us no such thing – is it so, here?
- At best, the hive mind of the market has struggled to absorb even the last supply in Austria. On Tuesday we get even more of the 10y
- Check out the picture of Z-Spread to Germany in EGB 10yrs on the cover sheet. You go from a worse credit France int Austria for a pick up – that defies the overall theme of credits and spreads
- We can sell France to buy RAGB Feb32 @ +8.9bp on z-spread mid
- At first we might think this 'Process' is non-Stationary – but if we look at the long term history of Austria 3m10y vs France 3mo10y (source: BBG) we are in a paradigm this year that should be a structural fade but it is mean reverting and volatility is somewhat contained

- Frtr Nov31 into Ragb feb32 on Z-Spread



- Long term history 3m10y Austria minus 3m10y France

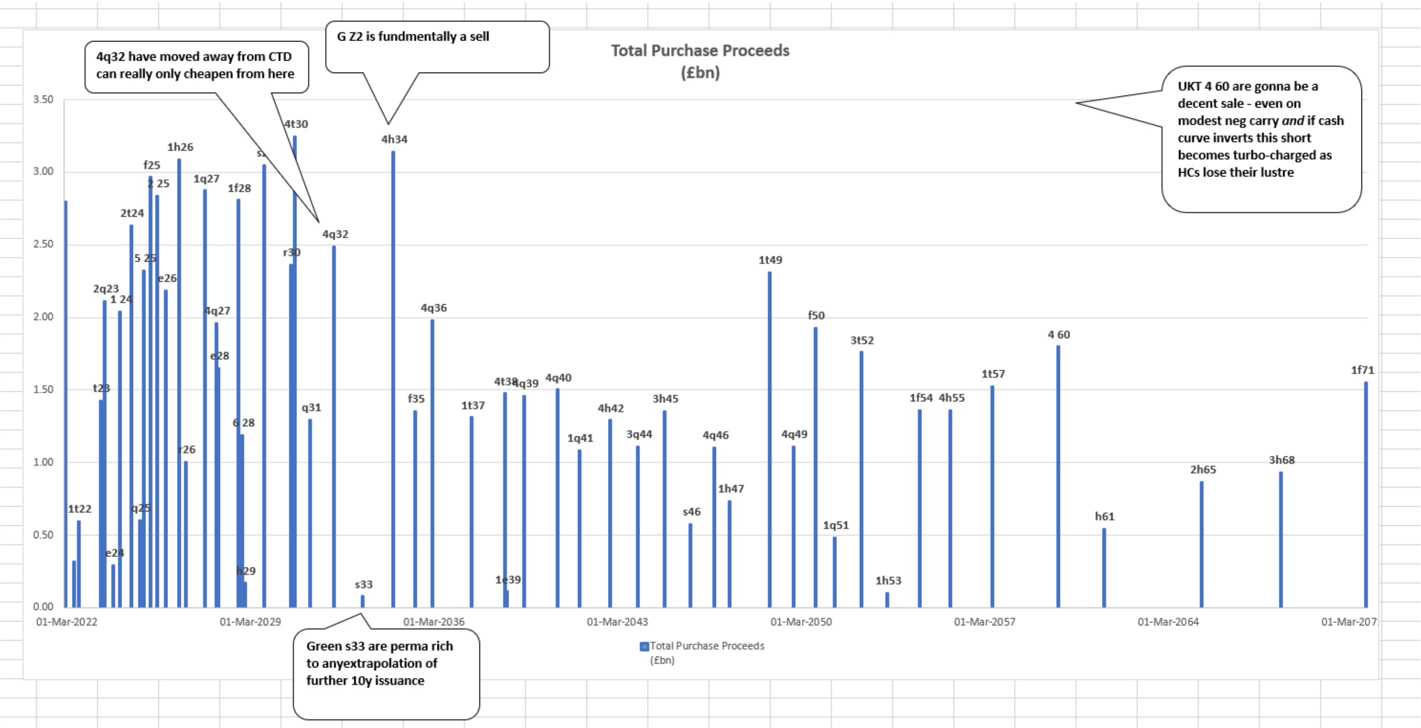
Trade Austria / France

- Sell France nov31 vs buy Ragb Feb32
- +16.75 bp, Mid +17.2bp

100 * ((YIELD[RAGB 0.9 02/20/32 Corp] - 1.0 * YIELD[FRTR 0 11/25/31 Corp]))

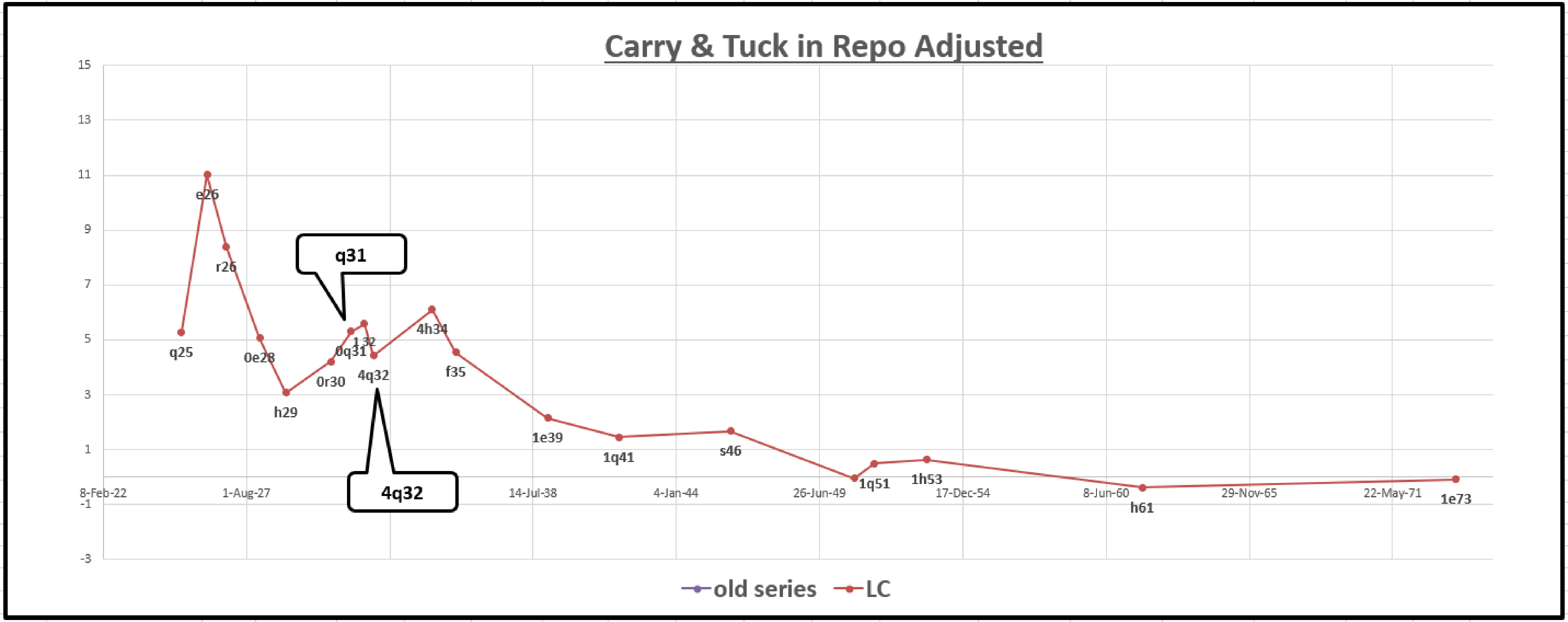
UKT simple steepener: QT owns loads of high coupons, 4q32 should have no premium as not close CTD and to be released form QE P/f

- We have the 1 32 supply coming on Wednesday
- Consider the published holdings of QE by nominal…
- The DMO owns vast quantities of these high coupon CTD bonds : 4q32 and 4t34
- The market is so entrenched in history that we have become almost immune to their richness
- I want to take advantage of their richness and the 1 32 supply, to do the simple steepener
- Sell UKT 4q32 / Buy q31



200 * (YIELD[UKT 4.25 06/07/32 Corp] - 1.0 * YIELD[UKT 0.25 07/31/31 Corp])

UKT Carry and Roll



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