

Wednesday, April 3rd, 2019

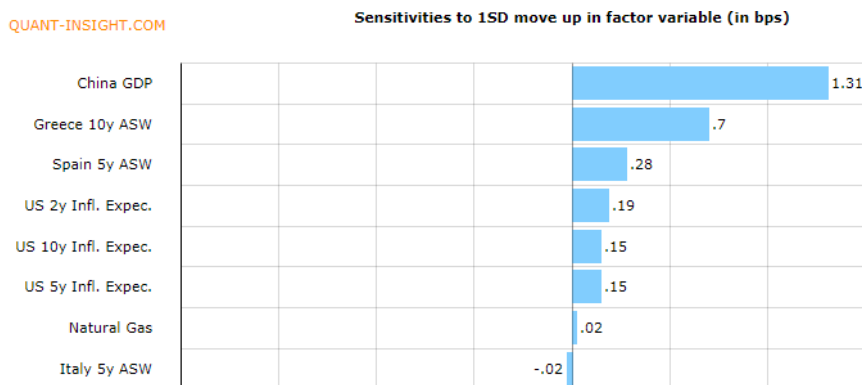
- *US yields are at a critical juncture where a confluence of factors are pointing to higher yields*
- *Given the gamma profile and critical support levels that are upon the market; an acceleration of the selloff has become increasingly likely*
- *Intelligent ways based on Prism models to position for this potential selloff*

The next day or so is going to be pivotal for yields. There are a confluence of drivers that can, at the very least, mean revert rates higher and perhaps even reverse the trend. Let's go through each...

- 1) **Global economic data** – after the Q1 growth scare, there has actually been some decent **\*\*forward looking\*\*** data that points to an economic bounce. So I am not talking employment data which lags the cycle, but obviously more enlightening data like PMI's. Since April Fool's we have seen:

- China "official" and Caixin Mfg PMI's bounce back above 50 and into expansion territory
- US Mfg PMI "beating" and Atlanta Fed GDPnow bouncing from a 0.2% low in March to a now healthy 2.07%
- UK Mfg PMI hitting the highest levels since Feb 2018
- Strong Services PMI's all over the world: China, Spain, Italy, France, Germany, EZ

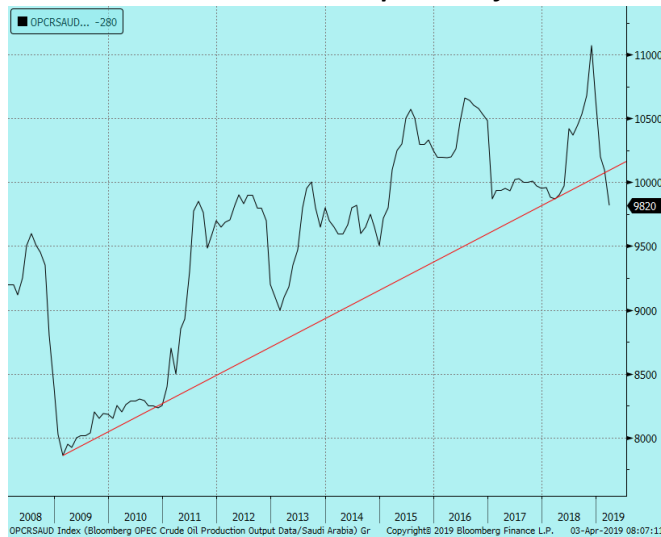
Why is the bounce in economic data, especially in China, important? Since I have been advocating downside in Blue Eurodollars, if you look at what are the primary drivers of EDM2 from a macro perspective, Chinese growth comes up as the #1 positive driver of higher Eurodollar yields...



Thus, if the economic data in China is going to bounce higher, we can confidently expect Eurodollars to sell off.

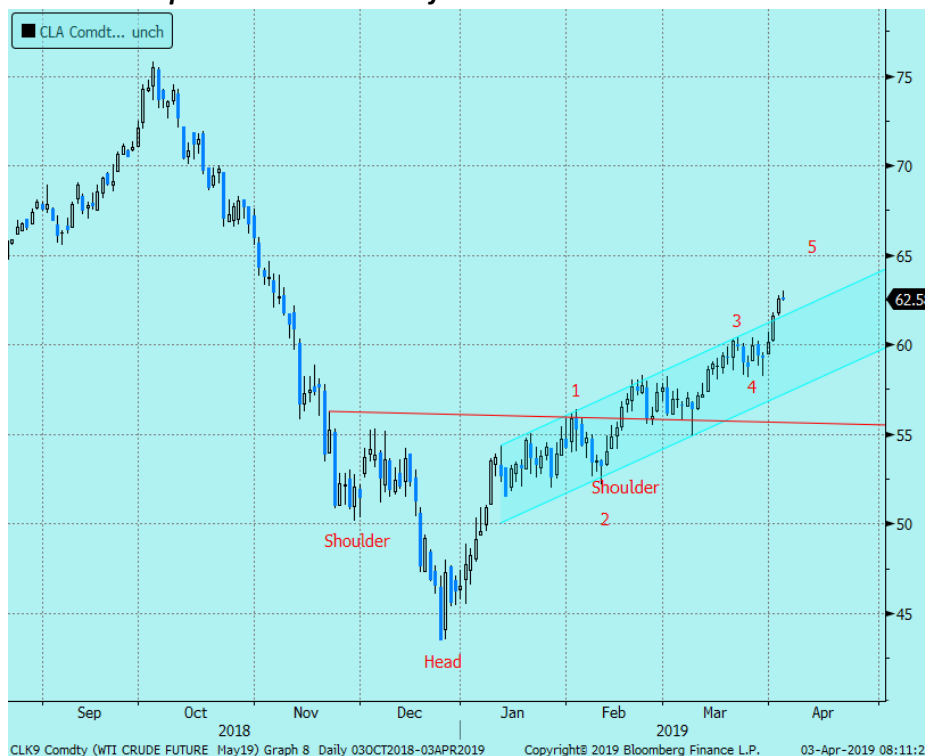
- 2) **Crude Oil and metals** – if you recall back to my note on March 13<sup>th</sup>, I gave a long list of reasons to be bullish WTI and that this would be the final leg up of the rally. Since, we have seen WTI climb from \$57.45 to \$62.60 (the target I gave was ~\$65). The quickest explanation why oil is rallying can be seen in the precipitous decline of Saudi production...

**OPEC Crude Oil Production Output Data for Saudi Arabia – has broken its 10-year uptrend...**



The cleanest explanation why Saudi production is falling is likely to allow the US supply glut to be sopped up which drives prices higher. The new explanation is a report out yesterday proclaiming that the Saudi's largest (and the world's largest as well) oil field (Ghawar) can produce A LOT less than previously thought (3.8m barrels/day vs. 5m expectations). That news has broken WTI out to the upside of its 3-month bull channel and brings it closer to its final target of \$65.

**WTI has broken its bull channel which usually reflects new news (the Ghawar news likely). The inverse head and shoulder pattern targets \$65 which would coincide with the final 5<sup>th</sup> and final Elliott Wave count. So there is still upside but it is limited from here...**

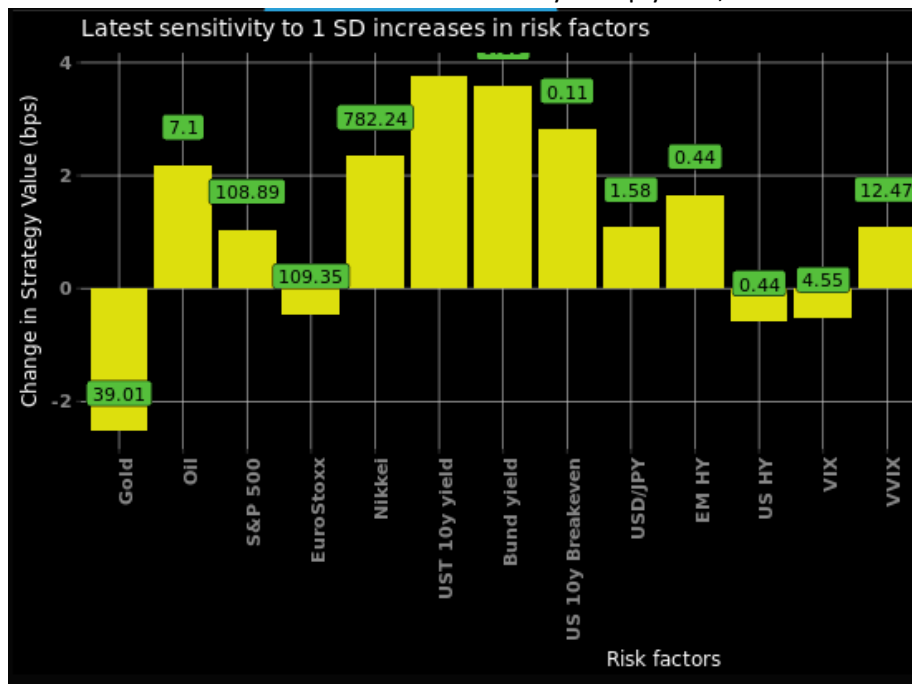


Having the insight on crude oil is obviously important as it feeds into inflation expectations which feeds into nominal yields. Thus, sticking with Blue Eurodollars, you can see how WTI led EDM2 on the way up, and now it is leading it on the way down....

### WTI (inverted in purple) vs. EDM2 (candlesticks)....



And as we can see in Prism's macro PCA of 10yr swap yields, Oil and Breakevens are large drivers...



Historically, metals have also been a significant driver of inflation expectations. On that note, it is worth mentioning that China is now limiting steel production in the Hebei and Tianjin provinces to cut capacity. In the past, these kinds of production cuts have led to higher metal prices and we can see today that steel rebar futures are getting perky with momentum shifting to the upside. Higher metal prices tend to lead to higher yields.

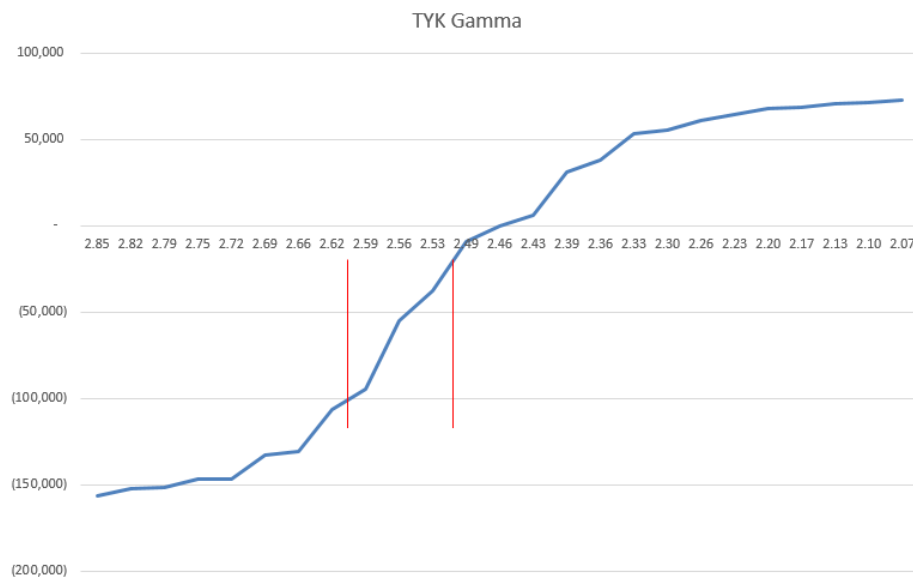
### Steel Rebar futures breaking out...



- 3) **Continued optimism over a China/US trade deal** – FT was out saying that the “US and China draw closer to a final trade agreement.” I don’t see too much new here as enforcement continues to be the sticking point but the light at the end of the tunnel grows nearer.
- 4) **Brexit delay** – the market has partially priced in a hard Brexit so that there would be no BOE hikes ever. Therefore, with this Brexit delay that could push off any action for 6m to 1yr, a hard Brexit becomes less likely which will mean the market will have to price out a bit of the pessimism.

These four drivers are important because (1) the market has piled into long fixed income exposures (~16m/01 in Eurodollars alone last week), and (2) as I showed on Monday, there is significant risk that gamma in May expiry UST options like TY’s can really accelerate any selloff. In fact, there has only been more gamma added since Monday (~25k more cts of gamma worth) so this 2.50% to 2.60% (in spot cash 10y terms) is the “sweet spot” for this selloff to pick up steam.

### May 10yr future gamma profile...



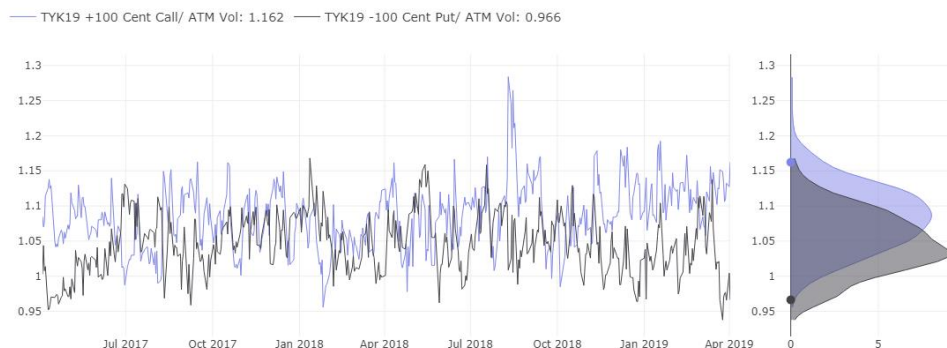
Lastly, I would note that the market is hitting a key trend following support level. For example, the 10yr note future is sitting on the ever important (for CTA types) 20-day moving average at 123-14. A break, especially given the gamma profile above, would also cause an acceleration of the selloff...



The mantra here this year has been the slowing economic data into the end of cycle dynamic, but even I admit that the market got ahead of its skis with the amount of cuts it priced in for 2019. Those cuts are at risk of being priced out given all the factors I noted above.

I continue to like:

- 1) Blue Eurodollar downside that I have been pounding the table on for a simple mean reversion:
  - 3EJ 97.625 put for 1.0/1.5
  - 3EK 97.625/97.50 put spread for 2.5/3.0 (this has richened quite a bit since first reco'd it so work bid only)
- 2) I also like selling Fed Fund futures in 2019 to price out cuts using some carry to buy an upside hedge
- 3) Also, TY downside looks attractive. From my colleague Rapha, you can see that TY put skew is not only extremely low, but INVERTED to ATM vol...



**I really believe it is prudent to have one of these expressions, or variations of, on at this point. Please let us know how we can help.**

Kind Regards,

**Mark Orsley**

Head of Macro Strategy, North America



130 West 42nd, 23 <sup>rd</sup> Floor	Tel	+1 646 205 6193
New York, NY 10019	Cell	+1 914 456 9446
United States	Email	<a href="mailto:orsley@prismfp.com">orsley@prismfp.com</a>

*#substantive*

*Prism Financial Products LP email disclaimer:*

*This communication and any attachments to it may be confidential, subject to legal privilege, or otherwise protected from disclosure, and is intended solely for the use of the intended recipient(s). If you are not the intended recipient, please immediately delete, destroy and make no further use or disclosure of it, and any attachments, printouts and copies of it, and notify Prism Financial Products LP ("Prism LP").*

*This communication is not intended for retail clients and Prism LP will not make such products or transactions available to retail clients. It is your responsibility to reach your own determination as to the status under MiFID II of the materials and products Prism LP provides to you, as well as to whether the relevant provisions of MiFID II would be applicable, in light of your current domicile and business activities. Prism LP may share any part or all of the materials contained herein with other clients before, at the same time, or after the materials are made available to your staff. The views contained herein are not a personal recommendation and do not take into account whether any product or transaction is suitable for a particular investor.*

*Prism LP is not responsible for information stated to be obtained or derived from third party sources or statistical services and makes no representation and accepts no responsibility or liability for the completeness or accuracy of this communication. No confidentiality or privilege is waived or lost by any mis-transmission. Recipients are advised to conduct their own virus checks. Prism LP may monitor and store communications by e-mail, other messaging services and telephone, to the extent permitted by law.*

*This communication is not an advertisement, an offer, invitation or a solicitation to buy or sell securities or investment products, an official confirmation of any kind and is not intended as investment advice or recommendation. Before making an investment decision, investors should ensure they have sufficient information to ascertain the legal, financial, tax and regulatory consequences of an investment to enable them to make an informed investment decision. The information in this communication is subject to change without notice. The performance and value of any financial product may fluctuate and may be subject to sudden and large movements that could result in a loss equal to or in excess of the amount invested. Past performance is not a reliable indicator of future results.*

*Prism LP is a limited liability company formed in the State of Delaware with registration number EIN 81-1326349 and authorized to do business in the State of New York at its registered office at 650 Fifth Avenue, 17th Floor, New York, NY 10019, United States of America. Prism LP is authorized and regulated by the National Futures Association and the Commodity Futures Trading Commission (NFA ID: 0496102) in the United States of America. Prism LP is an appointed representative of its affiliate Prism Financial Products LP in the United Kingdom, which is authorized and regulated by the Financial Conduct Authority (FRN: 607481). Prism LP's registered branch office (FRN: 782608) is at The Grove, 248A Marylebone Road, London, NW1 6JZ, United Kingdom. VAT registration number: 253 5845 88.*